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CONTENTS

FIRST SESSION

THURSDAY, MAY 20, 1954 — 9:30 A. M.
The Ohio Union — West Ballroom

Presiding:

FRANK ARNOLD, *C.P.A., President, The Ohio Society of Certified Public Accountants; Partner, Arnold, Hawk & Cuthbertson, Dayton, Ohio*

Paper: "Interpreting Figures for Operating Management"

CLARENCE SNYDER, *Controller, John A. Roebling's Sons Corporation, Subsidiary of The Colorado Fuel & Iron Corporation, Trenton, N.J.*

Paper: "Cost Controls in Returning to a Competitive Market"

I. WAYNE KELLER, *President, National Association of Cost Accountants, Controller, Armstrong Cork Company, Lancaster, Pa.*

FIRST SESSION

Introductory Remarks

Chairman Frank Arnold: It has long been the responsibility and pleasure of the current President of the Ohio Society of Certified Public Accountants to open and preside at the first session of the Annual Ohio State University's Institute of Accounting. Therefore, I now declare this sixteenth Institute on Accounting formally open, and welcome both the speakers and audience to the campus.

The Ohio State University's Institute on Accounting has become the outstanding University sponsored Institute on Accounting in our country. The accountants in Ohio, as well as the University are justly proud of this accomplishment. The University personnel over the years have made this record possible. It is not only because of the programs presented at these meetings, nor the physical plant making up this College of Commerce and Administration here at the University, but it is the reflection of the teachers and their ability to impart their knowledge to others. Full credit should be given to the personnel of the college for this enviable record.

Those of us who have attended many of the sixteen sessions know that each year outstanding speakers in their respective fields have been our instructors. These men are always willing to give of their time and talents because it has become an honor to appear on the program of this Institute. This year is no exception. An examination of the program shows that the subjects to be treated during this meeting are of a current and timely nature.

The first session will deal with the necessary tools for the operating management, and the controls recommended in returning to a competitive market.

Our first speaker this morning is returning to the campus of his Alma Mater, having graduated here in 1927 with a degree of Bachelor of Science in Business Administration, majoring in Public and Industrial Accounting. He also participated in many activities, including three years on the Varsity basketball team; was a football manager; and a member of Delta Sigma Pi.

His association and civic activities since leaving college are represented by speaking engagements before NACA Chapters and other professional societies on technical accounting and industrial management subjects. He was President of the Philadelphia Chapter of the National

Association of Cost Accountants in 1951-52, and was instrumental in organizing the Trenton Chapter of NACA. Currently he is First Vice President of the Trenton, New Jersey, Chamber of Commerce; a director of the Philadelphia Control, Controllers Institute of America; and a director of the New Jersey Taxpayers' Association.

After graduation from Ohio State, he spent thirteen years with the Marion Power Shovel Company of Marion, Ohio, where he became their Chief Accountant. In 1940 he became associated with John A. Roebling's Sons Corporation of Trenton, New Jersey, a subsidiary of The Colorado Fuel and Iron Corporation, the nation's ninth largest steel producer, where he currently holds the position of Controller and Assistant Secretary.

It is with pleasure that I present to you Mr. Clarence W. Snyder, who will talk to us on the subject of "Interpreting Figures for Operating Management." Mr. Snyder.

INTERPRETING FIGURES FOR OPERATING MANAGEMENT

By
Clarence W. Snyder
Controller, John A. Roebling's Sons Corporation, Trenton, N.J.

It is a pleasure and an honor, and I feel highly complimented to address you ladies and gentlemen at the opening session of the 16th Annual Institute on Accounting at the Ohio State University.

It has been 27 years since I left this campus and 14 years since I moved away from Ohio. I did attend the first and second meetings of this Institute in 1939 and 1940 and was here in the audience last year, where I should like to be right now.

I. *Introduction*

Because of the nature of my subject today, I do not expect my paper will make a great or permanent contribution to the science or technique of accounting, which incidentally has not changed much since I graduated here in 1927, although the use and application of the theory has been very greatly extended. However, I hope my presentation today will contribute somewhat to the art of our accounting profession.

The interpretation of figures for operating management is a subject which deals largely with people, bridging the huge gap between the visible product of our accounting technique "the figures in our statements" and the primary objective of it all, the "comprehension of such figures" and their effective use. The subject, therefore, is an educational and psychological one, and although I do not profess to be a teacher or a psychologist, I will proceed with my subject relying principally upon my experience in this area.

II. *Need for Interpretation*

Suppose we consider first the need or necessity for interpreting figures for management. First of all we must realize that in dealing with the managers in business today at the various levels, we are dealing with non-technical people, accounting-wise. Perhaps not more than 1 in 20 in the middle and higher levels of management has ever had more than an elementary course in accounting, and in the lower levels the ratio may even be as high as 1 to 100. They do not understand accounting lingo and should not be expected to do so. They often get confused between such fundamental terms as (a) gross profit at standard, (b) gross profit at actual, (c) net operating profit, (d) net income, and (e) net income after taxes, let alone some of our more eloquent terminology such as (a) above or below the line payments, (b) non-recurring liabilities, (c) debit balance unabsorbed variance, (d) Life replacement reserve debit, (e) paid-in and capital surplus, etc. Even when we use such a term as "sales" we may mean any one of about four different things depending upon whether we are talking about bookings, or billings, or shipments, or before or after returns and allowances, outbound freight, cash discount, etc.

Then again, even after we have "educated" our management people to our terminology, our figures, and our daily, weekly and monthly reports and their usefulness, we are faced with a constant turnover of managers due to resignations and promotions. Actually, I sometimes think we are dealing with a parade. In my own experience with three industrial corporations I have personally had to deal with seven presidents and general managers, eight general sales managers, seven general plant managers, five treasurers and at least 500 foremen and department heads. It is obvious, therefore, that the need for interpretation of figures is tremendous.

III. *Responsibility for Interpretation*

Let us now discuss the Responsibility for Interpretation. One of the most significant changes in management in recent years has been in the area of re-organizing to supply operating executives with facts and figures to aid in planning and decision making. In many companies a large need exists to provide the president or general manager with the facts and figures to help him carry out his primary job-planning, co-ordinating and taking corrective actions. Department heads also need help in making decisions in achieving overall company goals. Some companies have created a figure analysis staff to report directly to the president. This is the Control Section concept used by Koppers, TWA, North American Aviation and others. It is a growing form of organization. Other companies have separated figure gathering or accounting from figure analysis and interpretation within the Controller's organization. This form of organization is used by Ford, U. S. Steel and many others.

In the smaller organizations the interpretative function generally falls on the Controller or chief accounting officer. Very often, the way the management fulfills this need determines whether a man becomes a controller or a bookkeeper. The Controllers Institute of America clearly fixes the responsibility for interpretation on the Controller and as a matter of fact the interpretation function can very well be the most important part of his job.

There are many public accountants in the audience today. They, too, are very ably contributing substantially to this interpretation function, especially for the small businesses which cannot afford a staff or even a Controller.

Interpretation of business facts and figures has today supplanted mere recording as the chief function of accounting. Management today needs the kind of reports that suggest the proper course of present day and future action. It also expects in some cases the interpretative analysis to be briefly set forth in textual form and when called for, recommendations for action. Some companies like to dramatize the figures by presenting them in graphic form with charts, using various colors to indicate non-favorable (red) or favorable (green) trends. You have probably heard of the DuPont Company's famous charts and their chart room designed for use of the top management committee and the operating managers.

IV. *Areas of Management Confusion*

Now I want to discuss what I consider "Areas of Management Confusion." In order to introduce generally the areas of operating management confusion with accounting figures, as I have found them in industrial companies, I would like to relate an actual experience I had a few years ago with one top executive. A very able executive was employed and put in charge of all manufacturing operations which consisted of six very distinct product divisions, two of which produced the principal raw materials for the other four finishing divisions, but which also produced substantially for outside sale. This executive had had his previous experience in a small plant which carried very little finished goods inventory and shipped a large part of its production in the same month it was produced. He was accustomed to getting a monthly profit and loss statement which contained considerable detail relating all elements and items of manufacturing cost and selling and administrative costs to Net Sales either per ton or percentage-wise.

Naturally, this executive wanted accounting statements and figures similar to those previously experienced, and promptly announced to his six divisional superintendents that he was going to measure their overall performance and judge their effectiveness and efficiency by the figures set forth in the monthly profit and loss statements. He supplanted this announcement by requesting the Controller to produce a monthly profit and loss statement for the six manufacturing divisions, which was accomplished. Now let us review a few of the interpretations which were subsequently necessary to make for this executive and his superintendents.

(a) As you may suspect, very soon came a month in which the sales in one division increased over the previous month about 15 per cent, but the Net Operating Profit for the division was down 5 per cent, whereupon the executive could not understand it since selling prices, material prices and labor rates had not changed for several months. Since we were reporting under a newly installed standard cost system, I proceeded to explain the large increase in Under-absorbed Fixed Factory Overhead resulting from a decrease in the rate of production in this division. This is always a difficult thing to get across to the newcomer but after several months of trying you usually make the grade.

(b) The next month another situation arose in another division and the executive thought he had me trapped. Both the sales and the rate of production in the division were up with no price level changes, yet the Net Profit went down. This month it was necessary to tell him that it was the same old trouble, Under-absorbed Fixed Overhead. This time, however, it occurred in the two raw material originating divisions whose operations were curtailed due to a labor disturbance and it was necessary to pass a share of their Under-absorbed Overhead along to the Finishing Division. This was eventually understood, but was a hard thing to swallow for the Finishing Division Superintendent. He stated that he had no control over the other two divisions. This later resulted in making inter-division billings at market prices, which is not uncommon, but created the confusion of eliminating inter-company profit in reporting overall results and confused the highest level management because of two kinds of profit.

(c) The next month in another division, the Profit and Loss statement indicated the cost per ton jumped about eight per cent over the previous month and the profit went down accordingly for no apparent reason to the executive. This time it was necessary to explain that under our accounting policy, for inventory valuation we were on the "First In First Out" theory and since this division produced for stock and warehoused the finished goods nationwide with inventories equal to four months' production, the cost of sales in the month of May profit and loss statement was actually flowing out of inventory that was produced in the preceding January. Since there was a 24 cents per hour wage increase effective January 1st of that year, the January production costs were much higher than the cost of product produced in December which found its way into the April profit and loss statement. The executive, of course, was very much aware of the large wage increase, which he helped negotiate, but since that was over five months previous, he had almost forgotten about it. Furthermore, he had never before heard of Mr. LIFO and Mrs. FIFO. To further confuse this executive and all Divisional Superintendents, about a year later we switched to "Last In First Out" theory and had to go through the same interpretation all over again, except in reverse.

(d) Of course, I can carry this story on in detail indefinitely by referring to cases in which a change in the "product mix" seriously altered the Net Profit results with all other things being substantially equal. There were months, of course, in which Selling or Administrative Expense changes or Outbound Freight cost changes affected operating results favorably or unfavorably, the responsibility for which in no sense could be attributed to the factory superintendent.

(e) This executive's whole concept of controlling manufacturing operations by reference to a divisional profit and loss statement finally and completely broke down when one large division got very substantially in the red for a period of many months resulting from a series of steep selling price reductions due to economic and competitive conditions. The Divisional Superintendent involved was the scapegoat for the huge loss for a long time under the guise that the Sales Department was selling at regular prices established by competition they could do nothing about, and it was up to the Superintendent to trim his costs accordingly. When the situation got so bad that we were able to point out that the division would still be in the red even if the Superintendent could eliminate all of the wage and salary payrolls in the division, this theory of profit and loss accountability died forever. Obviously, there are many organizational responsibilities for "Net Profit" over which the production superintendent has no control. Needless to say, the factory management at this point was easy to sell on the theory of cost control by the use of standards on an operational and departmental basis accompanied by a vigorous and continual analysis of "Variations from Standard Cost."

I did not relate the foregoing experience with the intent of being in any way derogatory of the factory executive but to make several points brought out by the story. There are many operating executives in business today with theoretical accounting deficiencies and they are not all in manufacturing positions by any means. You should hear my Sales Manager's story some time, too. These situations must be recognized and they present a challenge to all of us charged with interpreting business operations.

Averages

(f) Now I would like to talk about what I call "The fallacy of averages." One of the very frequent mistakes of operating managers is to rely on "averages" instead of "specifics" in deciding a problem. We never make or sell an "average" commodity. We never use an "average" machine to process the product. There is no such thing. A comparison of the average cost to manufacture a ton of steel ingots in one plant with the cost in another plant may be entirely misleading to management due to difference in the specification of material or method of processing. A comparison of costs based upon a very specific specification and manufacturing method often gives a picture exactly the opposite of the average situation.

(g) The use or misuse of "average" figures is often very misleading when the Plant operating rate is near normal capacity and the sales department is demanding additional production because they can sell it. A comparison of "average" selling prices of a commodity group with average costs may indicate the additional volume profitable and desirable. However, the true figures may show otherwise, because the factory in order to produce this added volume may have to employ its less efficient equipment not normally used, or pay overtime premium for Saturday and Sunday work. Furthermore, the new business may very well be taken at a lower than normal price. Merely actually assigning this new business to the efficient equipment at straight time rates and producing the regular products on the inefficient equipment or during overtime periods does not help this situation, either, as some operating managers at first believe. Just last week we had occasion to point out the high cost of producing certain rush orders by overtime work on Saturdays and Sundays. Although the management knew of the 50 per cent premium paid to labor, they did not fully realize the increased ratio of supervision, inspection, clerks, etc., which occurred due to partial operation. These extra costs were getting buried in the average overhead rate. The use of average figures is often helpful to give operating people a general perspective of the business and to indicate general relationships; however, care must be exercised not to make the fatal mistake the statistician did when he drowned himself wading across a stream of water which averaged two feet deep.

Fixed and Variable Costs

(h) Probably one of the most misunderstood situations in manufacturing operations is the effect of fixed or period costs upon the monthly operating statement of Profit and Loss. Managers who have experienced one complete business cycle of high and low levels of operations know very well that more volume increases profits and decreases unit product costs, but many of them have a greatly exaggerated idea of the effect of this factor. The effect per sales dollar, of course, varies greatly with the product, the degree of fabrication required, and the fixed overhead of the cost centers through which the product is processed, and the amount of Selling and Engineering involved. Cost accountants can very accurately measure the influence of this factor and managers can be properly informed. You are familiar with "break even charts."

The customary accounting treatment of fixed factory costs flowing in and out of inventory values, with temporary suspension from the profit and loss statement due to timing (lifo or fifo) or inventory accumulating or inventory reductions, is usually not properly understood by operating people until it is thoroughly explained.

General

(i) There are, of course, many other areas of confusion which I do not have time to elaborate on here, and will merely mention two more.

1. The alternate product selection situation in which a commodity may have the highest gross profit percentage or the highest unit price per ton is not necessarily the best commodity to sell. In certain production bottleneck situations, the product that gives the greatest dollar profit per machine hour may be the better choice.

2. Another is the situation involving the interpretation of figures to justify the purchase of capital assets.

V. *Most Fruitful Areas of Interpretation*

Now what are the more fruitful or more productive areas of interpretation?

A. Probably the most fruitful areas of interpretation of figures arise from the company's overall Profit Planning Program or overall budgeting. In this area, problems arise concerning the selection of mix of products, elimination of unprofitable product lines, selection of sales territories, selection and method of sales distribution and so forth. Here proper figures and their intelligent interpretation can make the difference between a successful and an unsuccessful company.

B. Another very productive area often arises from situations involving "choice of alternate methods." The advisability of overtime operations or use of less efficient equipment previously referred to are examples in this area which often lead to substantial improvement in operating profit.

C. Interpretation or advice in the area of product pricing is sometimes very important especially if long-time contracts are involved and inflation is imminent.

D. We always have with us analysis and interpretation situations involving unit cost increases, analysis of variations from standard cost and so forth. These are routine and should never be neglected.

VI. *Qualifications of the Interpreter*

Now I should like to make a few comments concerning the qualifications of the person who is doing the interpreting. I am not at all certain you can teach a person how to interpret figures. I have seen experienced accountants look at a set of figures month after month and never grasp their significance from a management standpoint. I hesitate to say that good interpreters are born and not made; I can say, however, that the good ones have a sort of "feel" for the job or a sort of "sixth sense." Certainly you must have a good broad knowledge of the business and you can never stop acquiring knowledge about the business in all of its ramifications. One of the most important tools of the interpreter is his use of "ratios" or "percentages." I am not an engineer, but I have a slide rule on my desk all the time, and I really use it. By associating one fact with another or by comparing one fact with another, solutions to problems often become very evident. A single figure standing by itself is useless.

VII. *The Personality Factor*

I should like to conclude by making a few observations concerning the personality factor in the presentation and interpretation of facts and figures. This factor is very important and absolutely necessary to effective presentation. It is the human equation—you and I. Surprising or not, interpretations must often be sold to management. An expert told me last week that personality accounted for 85 per cent of successful selling.

The formula for effective interpretation is (a) the right information, plus (b) the right person, plus (c) an effective presentation.

The presentation and interpretation must be properly planned. There must be a logical sequence. You must be positive and definite. Non-technical terminology should be used as much as possible. Be practical. You must be pleasant, polite, courteous and human to all levels of management. In oral presentations, even voice quality, poise and posture are important. The interpreter must exercise ingenuity, persuasiveness, tact, he must have patience and perspective, pep and enthusiasm. Finally, I believe you need a lot of what Arthur Godfrey has recently popularized as "humility." With that word, this is a good point for me to quit talking and admit that I do not personally possess all of the wonderful virtues I have just enumerated, and I have never done as good a job interpreting figures for operating management as I hope you do after hearing me today. Thank you.

CHAIRMAN ARNOLD: We all wish to thank Mr. Snyder for his worthwhile and thought-provoking talk. With Mr. Snyder's permission, I would like to defer questions, which I know this audience has, until after we hear from the next speaker, Mr. Keller.

It is now our pleasure to hear from a friend of many years standing. This is especially true for all of us who have been active in the NACA work.

Mr. I. Wayne Keller is President of the National Association of Cost Accountants and Controller of the Armstrong Cork Company, Lancaster, Pennsylvania. He joined his company in 1930 as a cost accountant. Subsequently, he had staff and supervisory assignments in cost and corporate accounting in the general offices and Pittsburgh Plant of the company. These include the design and installation of the cost control and accounting procedures for domestic and foreign factories and subsidiaries. He was elected to his present position as of September 1, 1953.

He is well known throughout NACA for his activities as a speaker, writer, worker on various committees, and member of the Spot Club. He was president of the Lancaster Chapter in 1941-42, and was a vice president and director of that chapter for several years. On the national level he served as a vice president, a director for five years, chairman of the Committee on Research for three years, and was chairman of the Technical Program Committee for the annual conference held in Chicago in 1951.

Mr. Keller has contributed a number of articles to the NACA Bulletin and to many other technical and trade publications. He was the recipient of a Certificate of Merit in 1950 and 1952, and the Silver Medal in 1951 and 1953 under the Association's Lybrand Awards for outstanding contributions to the literature of industrial accounting. His writings have also been included in journals and books published in England.

He is a member of the American Institute of Accountants and the Pennsylvania Institute of Certified Public Accountants. He received his Bachelor of Science degree in Economics from Elizabethtown College and is active in the alumni association of that college, as well as in community affairs in Lancaster.

I now give you Mr. I. Wayne Keller, who will address us on the subject, "Cost Controls in Returning to a Competitive Market." Mr. Keller.

COST CONTROLS IN RETURNING TO A COMPETITIVE MARKET

By

I. Wayne Keller
President, National Association of Cost Accountants; Controller, Armstrong-Cork Company, Lancaster, Pa.

Mr. Chairman, Mr. Snyder, ladies and gentlemen. After listening to that introduction, I cannot help but appreciate the situation of two of the Amish boys in Lancaster County, who came to one of the local portrait painters to ask him to paint a picture of their father. He was rather surprised, because the Amish usually do not have pictures painted, but they said they were ready to pay the cost. His business had not been too good, and he felt that here was a job.

So he said, "When can father come in to sit for the portrait?" One son said, "Well, he can't. He is dead." "Oh, I am sorry," he said; "can I come out and see the body so that I can get an idea?" Again they looked at each other, and one said, "Unfortunately, no. We buried him a month ago."

Well, that stopped him just a bit. Then he said, "Possibly you have a picture of him." "No, we have no picture of him."

Then he was really hard put, but business was bad, so he thought he would go ahead. He said to the boys, "What kind of a man was he? Was he a heavy-set man or a slim man?" The one said, "He wasn't so heavy." The other said, "No, but he wasn't so slim."

The portrait painter said, "Did he have dark or light hair?" One son said, "It wasn't so dark." The other one said, "It wasn't so light."

It went on that way for a while. He tried to form some picture of the gentleman. Finally he said, "All right. You come back in two weeks, and I will have a portrait." Two weeks later they came in. He went over and took the cloth off the painting. They stood there and looked at it for a while. Then the older brother said to the other, "Well, that is papa, all right. But my, ain't he changed?"

I think after Clarence's comments this morning, and after that flattering introduction, if my son were in the audience he would say, "That is pop, all right. But my, ain't he changed?"

In looking at this subject of "Cost Controls in Returning to a Competitive Market," I was wondering if they picked that for me because of the frugality of the Pennsylvania Dutch. Perhaps it is rather appropriate that a Pennsylvania Dutchman discuss cost controls.

We get some unique cost controls sometimes. Two of these same Amishmen I referred to were shingling a roof, and one of them noticed that occasionally the other fellow would throw one of the nails away. "Why are you throwing those nails away?" he asked. The answer was, "The heads are on the wrong end." The first fellow then said, "Save them; we can use them when we lath the ceiling."

It has been evident for some time now that the productive capacity of American industry will be entirely adequate in 1954, and in many cases probably more than adequate, to meet all consumer demands. At the same time we have a relatively good level of personal income, and high individual savings, so that there is a plus factor in the economy, and the whole question today is whether or not the marketing ability and the creative abilities of American industry will be sufficient to create the desires to buy and to provide the products which will stimulate the economy. We must capitalize upon this potential, so as to have a real buyer's market.

If, then, we have returned to a competitive economy, it is necessary that we re-examine our cost control procedures, our policies and our techniques. We might ask, "What is the difference? Why should there be a difference whether we do or do not have a competitive market?"

In thinking of our subject this morning, there are three areas that I should like to consider. First is the effect on industry of the two types of markets; second is the influence of these on our cost control techniques; and finally, is the area of some of the tools of cost control.

In order to get background, I think that it is necessary to think for a moment on the differences between the two types of markets. Here we need to develop an understanding of the situations which have changed.

The buyers' market and the sellers' market are not in sharp contrast. The difference is not the same in one industry, nor within different companies in the same industry. Rather, it is a shading from black to white, through varying shades of gray, and the extent of the penetration into the gray area also varies, but for simplicity, let us look at some of the things as if they were sharp in contrast.

First, in the production area, there have been a lot of changes. Our production organizations have been accustomed to work from a high order backlog. The orders were in hand. It was a matter of scheduling, and they could plan the production schedules very carefully and efficiently on the basis of the high backlog of orders.

Today in contrast, most companies are in a service position. There is no longer the possibility of working from the high order backlog, but rather there are all the problems inherent to produce for inventory. Look at the product lines. During the period when you could sell anything you could make hay. Most companies shortened their product lines. It was necessary to get the longest possible runs. It was necessary to avoid frequent machine and pattern changes because of the necessity for getting out the maximum production.

But as we come into the competitive market, that picture changes. We need styles, models and colors in variety so we will have products which will appeal to the maximum number of potential customers. At the same time the warehouses during the sellers' market were relatively empty. Warehousing was necessary in order to group orders, and some things of that sort, but today in a servicing position, the warehouse function is extremely important. Products are produced for inventory and moved into the warehouse so that they will be available when the customers want them, and the warehouses are now full.

The second effect we note is in the purchasing area. Here it is somewhat the reverse of the company's relations with the customers. During the period of the sellers' market, orders were placed in advance. Specifications were adhered to, to the extent possible, but that was not always possible, and when you could not adhere to specifications, you took the material which was available. You carried relatively high inventories, because you wanted to be sure you had the material for production when it was needed.

Today orders are placed on a current basis. Receipts are scheduled so that the material is received at the plant approximately at the time it is used. There is every effort being made in many companies to move material directly from the source into the production line, and to use raw material stores in inventory to take care of emergencies. Along with that, specifications are adhered to rigidly. You want the material; you want the kind you want; and you want it when you want it.

The third area where we notice a marked change is in the marketing area. During the period of the sellers' market, the marketing function was largely one of distribution. Today it is one of hard selling. How quickly we have changed from a situation where we were allocating production and trying to keep the customers happy with what we were able to give them, to a case where we are selling, trying to get them to take as much as possible, even if it makes them a little unhappy.

The industrial production salesman today is studying the need of his customers. He is studying his products very carefully. He is working with staff and departments of his company in order that they may develop products which will meet the requirements of their customers. He is helping his customers to reduce and control their costs. Today the man selling in the industrial field is a sales engineer. He is not an order taker.

The consumer production salesman has experienced the same change. He no longer is simply taking orders from his people. He is studying the merchandise which he is selling to the consumers. He must know his product lines. He must know particularly their special merit, and why the customers should buy his line rather than the line of a competitor, so that he, too, has become a different type of individual. He is really a manufacturer's representative today and not an order taker.

Then this intensive selling effort is being backed up by intensive advertising programs. During the period of the sellers' market a substantial part of industrial advertising was of an institutional nature. You did not have to develop new customers or generate new desires for the product. Today the situation is changed. We have intensive product advertising. So that while today the customer can have anything he wants when he wants it, no effort is being spared to make him want a lot of it, and to make him want the merchandise that you are selling.

The fourth area we can take in a very broad sweep, let us call it the office function, and there we move from the executive level to the clerical level. I was very interested in Clarence Snyder's reports to management. One of the things I noticed in the competitive market, is that the executives are requesting more reports, or they are using the ones they have been receiving. They are asking more questions about the reports submitted by the accounting department. And the accountant is being brought into the management picture to a much greater extent in order to interpret and explain those things which are happening. The executives are giving increased attention to cost, price, volume relationships. They are calling on the staff departments to an even greater extent than they did when it was necessary to turn out production. The work of the staff departments in engineering, design and research are outstanding examples of the intensified effort to use those staff departments to improve service to customers, to increase the utility of our product for the customer. The work of the industrial engineer, the quality control engineer, the production planning man, and the accountant are outstanding examples of the efforts which are being made to control costs.

Finally, down at the clerical level, there is a decided change. There is definitely more paper work per dollar of sales. Orders were larger back in the time of the sellers' market than they are today in the competitive market, with the result that today customer's orders have changed. They need the material. You get a lot of special orders, and have more paper work. The fact that you reduce your purchase order size and are ordering on a current requirement basis has increased the paper work per dollar of sales.

I made some studies in our own company to see why, with certain changes in activity and certain locations. we were not able to reduce clerical staff, and I came up with some startling figures on the amount of paper work per dollar of purchase and sales, and the fact that the cost could not be changed substantially in total dollars.

Yes, the business climate is different today. So in this different situation we want to take a quick look at cost control. I think the first thing we should do is define our subject so that we are all thinking about the same thing. Definitions sometimes are precise; sometimes they are general terms, not understood.

So I think, lest we have any misconception of our subject matter, it is important that all of us give it the same definition. I would define cost control as the management technique of realizing the maximum value in contribution to profits from every dollar spent. I hope that you recognize that that definition is not synonymous with cost reduction. All too often we get off on the wrong foot. We feel that we have to embark on a cost reduction program. There are many, many instances where we should embark upon a cost increase program. As I move along, I hope to point out a few examples in those areas.

I also want to say that cost control in a competitive market is not necessarily keeping costs within established standards and budgets (if you have them), or within the limits of past experience. It calls for a re-examination of all of those areas. The very fact that we had established a standard during the sellers' market does not mean necessarily that it should be the standard during the competitive market. Neither does it mean that our current, well established standards are necessarily in every instance the top limits for costs. Cost must be examined, and every cost, every expenditure, must be related to the effect that it is going to have on the final net profit that we show on our financial statement. If it is necessary, in order to increase the final net profit, to go beyond the standard or budget for certain well defined and well established reasons, that is good cost control. In other words, we have to take a new look at all of the costs of the company.

In evaluating our cost controls I am going to emphasize today the philosophy of cost control rather than its detailed techniques and procedures. Clarence Snyder said he was speaking on the psychology of reports. I am speaking on the philosophy of control. All of you can develop techniques and procedures for your own individual companies. The broad approach, however, is applicable in any company.

The first movement in approaching cost control in a competitive market is to re-examine the organization structure. Mr. Snyder also referred to this, and it is extremely important. Responsibilities must be placed and known. I like particularly his comments about profit responsibility. How can you appraise a man in the production organization on the basis of the profit of the plant or his department when he has nothing to do with the income side of the business? Profit responsibility is a high level responsibility, and that must be recognized, and you will seriously handicap all of the cost control techniques if you try to move profit responsibility down the line.

Income responsibility must be separated from cost responsibility insofar as cost applies to the factory. Under income responsibility you have the responsibility for marketing costs, but all of those factors must be established in the organization structure. It is important that every man knows precisely those things for which he is responsible, and in line with that, it is necessary to the entire organization to know those things for which each man is responsible. It is not enough that it be told to the individual. It must be told to the organization. Communications become vitally important in setting these responsibilities.

In the second place, in the organization structure, there must be the proper attitude toward costs, cost control and profits. When the change to the competitive market is accompanied by a change in tax structures, for those companies in the excess profits tax bracket, it reduces the tax impact on the top dollar, and makes them 48 cent dollars in comparison with 18 cent dollars. It is extremely important to take a new look at all costs. It is also extremely important that everyone responsible for costs have the right attitude toward cost.

It was natural that during the period of high taxes there was more laxity with respect to costs than if taxes had not been so high. Management developed some bad habits of cost controlling, and along with that, increased costs could be passed on through increased sales factors.

There were two factors working against a tight appraisal of cost control. So that in settling the organization structure, and in placing responsibilities, it is also essential that every man who has responsibility through the organization have his thinking re-oriented through supervision and through training programs, so that he approaches the cost control problem with the right attitude. Along with setting of organization structure, getting the right attitude on the part of the supervisor — the man who is responsible for costs, there is a study of work loads. What have we done to determine how many things the supervisor has to do in the organization?

The sellers' market was one of expansion. During that period the organization grew. There were a lot of things when the climate was different, so that it was not necessary to devote so much time to some of these things, and work loads were added to individuals. Perhaps it was not possible to get an adequate number of supervisory staff or staff personnel, and because it was not, jobs were overlapping, and certain things were added here and there along the line.

Today, with a completely different atmosphere, with responsibility placed, and with a desire on the part of the man to do a completely thorough cost control job, does he have time to do it? For example, look at a foreman in the factory. I know some men who are so busy today trying to schedule all the machine changes and special orders coming into the picture, that they have very little time to give consideration to the problems of cost, methods and procedures in their department. They do not have the time they need to work with their personnel, and to train them to do an effective cost control job.

The warehouse superintendent is darting around madly today, trying to find space for finished products. He is trying to get the material in and out quickly. He does not have very much time to study methods and procedures and new handling equipment which might reduce costs.

So the work load of the organization must be right, as well as employee attitudes, and the placement of responsibility.

The second phase of the evaluation of our cost control techniques is the costs themselves. As I stated previously, it is extremely important that we view every item of cost as if we were a completely new company. What are we spending? Why are we spending it? What do we expect to get for it? Even if we have well established standards and budgets, it is important that they be re-examined. Sometimes we are forced to do that.

There was a certain product being sold for several years in a company's line. It had been well engineered; the laboratory had been in the picture. Production standards were set: specifications, raw materials, sales standards, costs developed and adhered to in the production of the item. Everything seemed lovely. The profit margin was reasonable.

There seemed no reason why the costs should be re-examined until one of the customers pressed for a price reduction. He was very insistent about it, to the extent of saying that it would be necessary to use a substitute material if the price were not reduced. So the accounting department was asked to re-examine the cost structure. Everything was studied in detail. The industrial engineers and the laboratory technicians came into the picture; every cost item was examined.

It became obvious that there was one factor which caused the high cost, and that was surface blisters experienced in the finished product. Everything apparently had been done to eliminate them, so that a scrap allowance of the finished product of 12 per cent was built into the standards, and everyone was happy when able to live within the 12 per cent scrap allowance. That did not seem possible if the price were going to be reduced.

So, further work was done. In the course of working on it, the laboratory came up by some chance, as those things usually happen, with a finer raw material that they had ground themselves. Test runs were made, and the surface blisters were eliminated. Then the new problem was to secure that raw material in quantity, and it was found there was no supplier manufacturing that particular material. Some of them had capacity, but did not have the ability; they did not have the staff to change their particular operation so that they could produce the new raw material. Engineers were sent to the supplier to work with him. They enabled him to make modifications in his production equipment. Consequently, the finer material was secured; the surface blisters were eliminated; costs were reduced; the price was reduced; and the business was retained at a reasonable profit. There was a perfect example of well-engineered standards in which everyone participated.

If the pressure had not come for price reduction, probably everyone would have thought a good cost control job was being done. The important thing is that those cost items be examined and brought out, and if possible, reduced. In this case, we have cost reduction possible before the pressure comes from the outside. You are in a much stronger position if you can offer a lower price to a customer.

In examining these items of cost, we have to go back to management policy toward controls. Sometimes management has certain bench marks they use. Those bench marks may be good. They may be bad. Let me cite an example. The National Association of Cost Accountants publishes its research study on marketing costs. In making the study they come up with examples which indicate that in a number of companies, the amount of advertising expenditure is determined as a percentage of the sales dollar. That may be a good management guide in some companies, but I question it very much.

It seems that in a competitive market it is necessary to spend substantially more money per sales dollar for advertising, particularly if you have a consumer market, than it is when you are in a sellers' market. But there is an old bench mark that has come through a number of companies and is being followed today. That is not cost control, because the bench mark is wrong. You have to re-examine the costs, and re-examine the policy back of the costs. It seems there is a perfect example of where it is necessary to spend more money in order to make money.

In evaluating the cost control techniques, it is necessary to look at the cost accounting system itself. Is the cost accounting system which we are using today adequate to meet all the demands of the competitive market? Is it adequate to provide management with the reports that they need to provide the sales department with prices which will get the business? I am not going to talk about a specific system today, because systems must be tailormade. There is no one best system, but there are general requirements:

1) The system must provide for the segregation of costs by areas of responsibility.

2) It must present costs in the terms in which management in each area is accustomed to think and plan.

3) It must relate costs to appropriate measurements of productivity or activity.

4) It must provide control data on a current basis before and while costs are incurred.

5) It must permit the allocation of general expenses on an equitable basis to operations, orders, product lines, and other units of the business.

6) It must reveal clearly the effect of volume on unit costs.

7) It must stimulate competitive pricing.

Most of these requirements are existent in a cost system in any type of a market, but they become of much greater importance in the competitive market, particularly if the cost system provides all of the information which is necessary to stimulate top management and the sales organization to competitive pricing; if it tells management where to spend money to make money; if it tells management what costs are significant and require attention to improve quality or to reduce costs and sales prices, or strengthen the competitive position; if it provides data for limiting costs to the amounts reflected in the sales prices. If it has all of those things, it is a good system for a competitive market. Just one caution—do not over-systematize. Sometimes we become so efficient that we become inefficient.

I had an example of that in Lancaster during the war. I was walking along and got a cinder in my eye. This was painful, so I went to the office of a doctor nearby, who had a very efficient nurse at the desk. I said, "Is the doctor in?" "Are you a regular patient?" I said, "No, this is an emergency. I won't need much of the doctor's time." She said, "I don't want to know what is the matter. We are busy. You can see the doctor in ten minutes. Go back and take off your clothes." I said, "I don't have to go through that routine. All . . ." She said, "Go back to room B and take off your clothes."

So I went back to room B, took off my clothes and sat down. On the other side of the room, there was a fellow sitting. He had taken his clothes off, and was holding a package in his lap. I said, "This is the silliest thing I have ever been through. I have a cinder in my eye, and I have to take off my clothes. I feel foolish."

This man said, "You feel foolish! How to you think I feel? All I am trying to do is deliver this package from the Railway Express."

In conclusion, let us look for a few minutes at the tools of cost control. Reference has been made today to standards, to budgets. Probably some of you are thinking, "Well, we don't have the technical staff or the scientific development of standards. We are not equipped to do that. We have to use past experience." Past experience can be all right, if your standards, your bench marks, or whatever you call them, particularly out in the factory, are based on an informed appraisal of past experience.

Many times if the worker on a machine is taken into your confidence and you work with him, not with the idea of doing something to set an incentive rate for him—I am talking particularly of the small company—but in getting him to help you, you can do a rather good job. Go to the machine man. Take an old fellow who has been running the machine for many years, and say, "How is it running?" "Pretty good." "How many are you turning out?" "About 200 an hour." "You have done better than that, haven't you?" "Yes, we did when the steel was better." "What is the best you have done?" "We got up to 300 an hour." "You wouldn't do that all the time, would you?" "No, with tool changes, you couldn't, but if the steel is right, we ought to do 275 an hour, but sometimes we are down to 100."

That little conversation has set a standard. Certainly, it is not scientific. Maybe you do not want to take the 275. But through that sort of conversation with the man on the line, without an industrial engineer on the place, without any scientific time study, and without going back and examining thousands of past production reports, you have set a standard, and I will bet it is a pretty good standard. Whether you are using experience or scientific engineered standards (which I think are better when you can have them), it is important that standards be established, and used as one of the tools for cost control in the competitive economy.

It is necessary to know what the costs should be before they are incurred. You cannot lock the stable after the horse is stolen. Your standards can be applied for your direct cost, your direct materials, your direct labor, your direct expense. They will vary with production volume, but when you come to indirect expenses, you need a budget and you need to pre-plan your expenses.

Here, of course, in the budgeting we can go into the factory and marketing and administrative area, but particularly the production. There is an important tool for control.

Let me add that the fixed budget for factory expense is just as out-of-date as the model T Ford, because in establishing the fixed budget for factory expense, you have to estimate what your production is going to be, and estimate what money you are going to expend for the expense element of cost to produce that level. Things change too rapidly for that. You need sharper measures.

It is necessary to know how much money should be spent; whether you are going to work five days, one-shift; what is going to happen when you go to two-shift operation; what is going to happen if you go to a Saturday and Sunday shift, as Mr. Snyder pointed out. How much more should that cost you? It is true that sometimes you have to do it in order to service customers. But how much more should that cost?

Do you know how many more clerks should be brought in? How many supervisors should be there? How many maintenance men should be on the job? How many set-up men should be on the job when you are running that extra five, six or seven days, or extra shift? Has a budget been built by steps for every possible combination of production activity?

Only if that has been done can you really effectively control your costs.

Then another thing, the men who are responsible for cost control should have those budget figures, and they should have their standards when they are given the production schedule. It is unfair to the man on the line to give him a production schedule and say, "You go ahead and run this, and control your costs," and then perhaps 15 or 20 days later give him a variance report and say, "You didn't do so much," or "You did very well." What can the poor fellow do? The parade is gone. But on that production schedule or job order which you give him, your unit standards should be shown; how many men; how many labor hours per unit; the number of maintenance men; the number of machines; the number of set-up men for that particular schedule level of operation. Give that to him.

It is simple to take the standards, and the budget and make a few calculations, and every time you change the schedule, change the stated requirement so that he can give attention to controlling his costs and keeping them within limits you set for him. He does not have to second-guess and decide, and have you come along sometime later and tell him he either did, or did not do a good job.

That does not mean that we do not need reports. Mr. Snyder already spoke of the reports. I simply want to add to that. We need a completely integrated system of reports, because after we have shown the men what they should spend, it is necessary to show them what has been accomplished, but more important, it is necessary to show them why there were deviations. You say, "They may know why." They may, but perhaps the parade was moving so rapidly that while they were occupied in this corner of the department, something happened that they did not see. So the "why" is so extremely important in these cost control reports, particularly in the competitive economy, and I made reference to stating them in terms that are used by the recipient.

I have no time for dollar variance reports for a production foreman on the line. That fellow is not accustomed to think in dollars. He is accustomed to think in terms of men, machines and material. And you cannot expect him to go through a lot of mental gymnastics in transferring his number of men or speed into dollars of cost, and evaluate the effect of that; but if you tell him his machine should have been 2,000 square yards per hour, and he achieved only 1,900, that is something which he understands.

If he keeps his unit standards under control, the top profit standards will take care of themselves. So it is important that every report be geared to the terms that are customarily used by the recipient, and the system of reports must be integrated so the activity at one level can be brought together to give an appraisal, report and assistance to activity at the next level, and so on up to the top.

It would be most disconcerting to find that profits as forecast were not realized, and that everybody down the line had lower costs than budget and standards, and had more income than forecast, and yet that is possible if we do not integrate the system of reports.

With all of it, the personal equation, the personal factor and contact, cost control cannot be effective if the cost accountant is sitting in a home office or general office far removed from the people who are using the figures. In cost control, when we come to the assistants, to the production organization, or to the sales organization, wherever we are, it is essential if it is going to be effective that we work personally with the individuals who have the responsibilities.

These are not new ideas. We have looked at the competitive market, in comparison with the sellers' market. We have given recognition to some of the new problems. We pointed up the necessity for re-examining the organization structure, re-examining our costs, re-examining cost accounting systems. We also talked about the tools of cost control, that is, the importance of ascertaining that the right amount of money is being spent in each area for the right thing. There is nothing new about this. It should be done in a sellers' market. It is essential that it be done in the competitive market, or it is quite probable that the competitive market may become a depression market.

DISCUSSION

CHAIRMAN ARNOLD: As always, Mr. Keller has given us many sound facts to assimilate. I am certain that you have many questions for him, although he has developed his subject clearly and well.

We now have a question and answer period for a few moments. Those of you who have questions for either Mr. Snyder or Mr. Keller, I wish you would stand, state your name, to whom you direct your question, and then state your question. Now, who wants to start this very interesting part of the program?

MR. JOHN EMERY (Cols. & Southern Ohio Elec. Co., Columbus): I want to ask Mr. Keller to what extent would you consult with the supervisor or line people in establishing the standards which you say you would give back to them, together with the production schedule?

MR. KELLER: To the fullest extent possible. I do not think it is fair to give a man a measuring stick if he did not participate in the development of that measuring stick. There are some times when it is virtually impossible to get agreement. Somebody has to make a decision, but to the fullest extent possible every supervisor responsible for costs should participate in the development of the standards or budgets that will be used to measure his activity. Otherwise, there are things which may be omitted in the standards. Because of his familiarity with the operation, and the staff personnel's lack of familiarity, as well as the psychology of it, it is well to do that. Many times when you bring the production man in to the picture, you will come up with a tighter standard than if you set it by engineering study alone. There is much more pride on his part in saying, "I was able to set a tight standard."

Another important factor is the attitude toward deviation, particularly negative or unfavorable deviation. If there is a beating of the air or rapping of the knuckles, the fellow does not meet the standards, then you get some reaction on his part, "I am going to the President." If he gets more praise in setting a tight standard, and fails to meet it, sometimes rather than punish him for not meeting a standard, you will get a better standard and better costs.

MR. CHARLES GEHLER (C.P.A., Cincinnati): I will address this to Mr. Keller. You said something about budgeting fixed expenses on various volume levels, or single shift, double shift, and so forth. How would you compare the actual fixed expense to the budget fixed expenses?

MR. KELLER: Sometimes we do that in our company. I may as well get down to specifics. We may have three or four different combinations during the period of a month. Perhaps the first week we will operate five days; the second week we will operate six days; third week we may go up to seven, or expand from 8-hour shifts to a 10-hour shift. So that from day to day, or week to week, as the production schedule is set, the specific information is given to the production foreman, mostly in terms of the number of men that he should have for that particular schedule of work. When we come to the end of the month, however, and we pull those figures together to report to the plant manager, we measure the activity for each period against a specific budget allowance, geared to the production schedule, so that the dollar budget either for the month may be a combination of the application of two or three of these different step budgets, which were selected to tie in with actual operating conditions.

MR. GEORGE B. TALMADGE (Lybrand, Ross Bros. & Montgomery, Cleveland): I should like to ask Mr. Snyder why he feels he has to allocate the unabsorbed overhead of one manufacturing plant to a plant doing the further fabrication, as he indicated.

MR. SNYDER: If you are coming up with actual profit and loss statements by product groups for the whole company, you have to get rid of all your costs and all your under-absorbed or over-absorbed. So in the producing division, maybe three-fourths of the producing division's production is used in other divisions, and one-fourth is outside sales. So it certainly would not be fair to slug the unabsorbed in one of the originating divisions, against the amount of sales that went in and also against the outside sales. It is an unrelated relationship and would distort the picture of how you were coming out on outside sales. It is basically a problem of actual cost accounting, of spreading the actual costs ultimately over the business which you produce, regardless of division. I do not know whether that answers you, but you have to get rid of it. You cannot get rid of it on an originating division.

MR. GEORGE TALMADGE: What basis of allocation do you use?

MR. SNYDER: We have been playing around with that in two or three different ways. If you are on pure, actual cost accounting, ordinarily acceptable by the government for various cost purposes, you have to throw the fixed overhead in a month over the production for the month, regardless of where it goes. In other words, you attach your actual overhead costs and actual production in that originating division for the month. If you are only operating half-of-normal, your overhead and everything produces double, and whoever gets that production outside sales or another division is getting a double sock for overhead. That is probably Hoyle in old fashioned actual cost accounting.

For our own purposes, though, we have flowed this unabsorbed overhead in the division to the other divisions, based on an annual forecast of what each of the divisions at the beginning of the year or your budget period say they want of the originating division's product. In other words, if one division wants one-fourth of the product, they say at the beginning of the year that they want one-fourth of the product of the producing raw material division.

Under that concept you sock them with one-fourth of it, whether they get a lot of material or not. Those are the two concepts. Partly you do what management wants. That latter concept is probably not good, acceptable theory from the standpoint of actual cost of a government contract, but it is good management control theory.

MR. HUGO WENZEL (Timken Roller Bearing Co., Columbus): I will direct this to Mr. Keller. You spoke in the case of budgeting units to men in the shop. I presume you mean pieces or pounds or tonnage. What do you do about types of controllable or budgeted expense, like tools and supplies and machine repairs?

MR. KELLER: There are some items where you have to use dollars. It is impossible to get away from the dollar concept completely. You may have some general machine overhauls, which would include operating hours, but for some phases of maintenance budget, you have to use dollars, and at those times all they see are the dollar figures. They are not accustomed to thinking in terms of gears going on the machine or replacement parts, but it pays where they are thinking in terms of the number of machine set-up men that they need per operating shift, or machine speeds, if you will keep it in units, keep it simple, and stay away from dollars as far as possible.

On the maintenance side, many times a foreman does his report, the machine is broken down, and it is up to the maintenance department coming in to fix it, and then the responsibility for the total cost is not the foreman's. It is part of the maintenance department cost, and you are measuring them. There is a case where you have to use dollars.

MR. D. R. REDMAN (The Ohio Fuel Gas Co., Columbus): I should like to address a question to Mr. Keller. In our experience in setting initial standards and in changing standards already set, we have had a great deal of difficulty with the unions. I want to know whether you feel this is a proper subject for union negotiations.

MR. KELLER: Do I gather that your standards are related to your wage payment plan?

MR. REDMAN: That is correct.

MR. KELLER: Of course, where you have that situation existing, certainly you have to negotiate if you are going to change the basis of wages. However, if you are fortunate enough to have your standards as one thing, and your wage payment plan as something else, then you can go ahead and change the standards for internal control without difficulties with the union.

MR. REDMAN: Are they not necessarily tied together in the eventual solution?

MR. KELLER: Not necessarily. That was one reason I was emphasizing unit standards for control, and your standards are set on the basis of so many labor hours or so many pieces per labor hour, for so many square yards per crew hour if you have a crew unit, you can do that without applying any rates to them at all, and you can get control.

Then, if your wage pattern changes in the factory, you can change the evaluation of those standards for your standards cost cards, for your pricing purposes, and that sort of thing, but the foreman does not have to shift his thinking at all. Your basic machine speed has not changed. If you have not been able to do anything on it, it operates at that speed. The foreman is still thinking in those terms, and as long as he meets those standards, the dollars will have to take care of themselves.

MR. REDMAN: Not to belabor the point, but if you had set a standard of 1,000 hours a day, which you saw was insufficient upon subsequent examination, and you decided the workers could do 1,200 a day, the union would say "That is a speed up." They refuse in many instances to go along with increased production, preferring to spread out rather than speed up, and there you are back in relations with the union.

MR. KELLER: You cannot get away from that.

PROFESSOR C. F. REIMER (Western Reserve University, Cleveland): I want to know Mr. Keller's attitude toward the use of a semi-variable classification of expense in a flexible budget.

MR. KELLER: When you get into your dollar budgeting, there are certain expenses that you arrive at; you might say that a fixed and variable component for the same item may be your operating supplies, so that you have so many dollars of fixed expense plus a variable rate per unit of activity. Very frequently, however, if you go back of that, and break down your expense classifications, you will find that they are not as semi-variable as you think, but that there are certain items which tend to be fixed, and there are other items which tend to be variable.

That is not universal, however, and there are exceptions where you have the semi-variable factor, and either through formulation or through individual examination for the scatter chart, or something of that sort, you come up with a fixed component plus a variable rate, and you have to give recognition to that, but when you have the fixed component, you have to examine the operating conditions, and see if that will change if you go to two or three shifts. You cannot take it from zero to a hundred per cent of capacity after you formulate it for one range of activity, and assume that the fixed element you formulated will be the fixed level if your operating schedule changes. It is probable that you will get a different behavior pattern of your costs if you expand in shifts or days of work. When you get into the fixed block, you have to get back to the step budget for the various possible activity levels of the organization if you are really going to have sharp control of your expenses.

Just drawing a line from top to bottom tends to average out too many steps, and as Clarence Snyder said, the worst thing you can have is too many averages. You have to give way to the importance of the cost of the clerical effort, the staff effort of setting a budget that way, and the clerical effort of applying it. All of those factors must be evaluated, but if the cost is significant, it is important to go that far.

MR. EBEN CUTLER (Arnold, Hawk & Cuthbertson, Dayton): I have a question for Mr. Keller. You referred to the increase in paper work, due to the changing times, without purchase orders and smaller sales orders. Have you ever found that unit studies, standards in paper work, are useful?

MR. KELLER: The question is whether a study of activity production units in paper work departments is useful. Yes, I think they are extremely useful, and I would feel lost if I did not have them as guides in those operations to which they are applicable, such as key punch or the number of invoices processed, and the number of receiving reports that are processed. I think that it is just as important there that we have the unit standards to measure office productivity as that we have unit standards to measure the production of the man running the machine in the factory. I think they are very useful.

CHAIRMAN ARNOLD: I wish to thank Mr. Snyder and Mr. Keller on behalf of the University for the splendid job they did. The success of this first session qualifies this as another high merit institute.

SECOND SESSION

THURSDAY, MAY 20, 1954 — 1:00 P.M.
The Ohio Union — East Ballroom

Presiding:

FRANK ARNOLD, *C.P.A., President, The Ohio Society of Certified Public Accountants; Partner, Arnold, Hawk & Cuthbertson, Dayton, Ohio*

Presentation of The Ohio Society of Certified Public Accountants award to highest C.P.A. candidate in the Fall 1953 examination

SECOND SESSION

Introductory Remarks

Chairman Arnold: Through the cooperation of the University, the Ohio Society of Certified Public Accountants has at this session been able to recognize the students of accounting who have placed highest in the fall CPA examination. It is our pleasure to honor these men. At this point, I want to present Dr. Paul E. Fertig, Chairman of the Accounting Education Committee of the Ohio Society, who will make the presentation. Dr. Fertig.

Dr. Paul E. Fertig: Chairman Arnold, honored guests, ladies and gentlemen. I do not have any idea how many of you are CPA's. But of those who are CPA's, I will wager that 98 per cent of you prefer not to know what your grade was when you took the examination. To most of us, the only significance of the grade was whether or not it was above 75.

Whether you are CPA'S or not, I think that almost all of us at a meeting of this kind, where education is a primary objective, would have sincere admiration for technical and professional excellence.

The Ohio Society, in making these awards, wants to give expression to that admiration. The Ohio Society recognizes the two top ranking candidates in each CPA examination in Ohio. The spring examination winners are honored at the annual meeting of the Ohio Society in September, and the November examination winners are honored at our Accounting Institute.

The recognition this year takes three forms. First is a parchment scroll. Secondly, and this is a new thing this year, is an engraved copy of the CPA man's profession, with which I am sure a great many of you are already familiar. It is a compilation of three articles reprinted from the CPA Handbook, published by the American Institute on Accountants. Two of the three authors, Mr. Carey and Mr. Foye, have just been presented to you. The third form is a one year membership in the Ohio Society of CPA's.

To add to the suspense, I will present the winner of the second place award first. Theodore P. Herrick is known to all of us at the Ohio State University as Ted, since he was on the teaching staff until the end of 1951, at which time he went to Cleveland with the Cleveland office of Arthur Young and Company. Ted holds two degrees, both of which were awarded by a college up north of Toledo in a town named Ann Arbor. Ted is well on his way to an additional degree at the Ohio State University. The second place winner, Ted Herrick.

MR. THEODORE P. HERRICK: Thank you very much, Dr. Fertig. I had a 12-page speech, but I decided not to give it. In case any of you did not know, Paul and I were students at the University of Michigan together. He apparently has forgotten that.

I have nothing in particular to say, other than that I am very honored. I certainly thank the University and the Ohio State Society of Certified Public Accountants for this honor. It is one that I will never forget. Thank you very much.

DR. FERTIG: Mr. Thomas V. Palmisano is also from Cleveland. Aside from that, his background differs from Mr. Herrick's. Mr. Palmisano has been with the Internal Revenue Service in Cleveland nine years. Prior to that he was Chief Petty Officer on a supply ship in the United States Navy during the War, and has had three years of accounting at Fenn College. First place winner, Mr. Thomas Palmisano, and I might add, with an extremely high mark on all sections of the examination.

MR. THOMAS V. PALMISANO: I was very pleased and very surprised to receive the news that I received the highest grade in the State. I think a special vote of thanks should go to the graders, and also a special vote of thanks to the Ohio Society and The Ohio State University for inviting me down here to this Institute. Thank you very much.

DR. FERTIG: Thank you very much. Now, Chairman Arnold.

CHAIRMAN ARNOLD: Thanks, Dr. Fertig, and congratulations to the Ohio Society, Mr. Palmisano and Mr. Herrick.

THIRD SESSION

THURSDAY, MAY 20, 1954 — 2:30 P.M.
The Ohio Union — West Ballroom

Presiding:

FRANK P. SMITH, *President, American Accounting Association; Director, Bureau of Business Research, University of Michigan, Ann Arbor, Michigan*

Paper: "Product Line Earnings Under Direct Costing"

JONATHAN N. HARRIS, *Industrial Accounting Consultant, Cambridge, Massachusetts*

Paper: "Professional Standards"

ARTHUR B. FOYE, *C.P.A., President, American Institute of Accountants; Partner, Haskins & Sells, New York, N. Y.*

THIRD SESSION

Introductory Remarks

Chairman Frank P. Smith: Ladies and gentlemen. We have a program this afternoon which combines two of the most interesting, challenging topics of 1954. Direct costing is being discussed wherever accountants are meeting these days. It has even crept into the academic world. I should get in a plug for my association. I want to state that we have this topic in the American Accounting Association this fall. So if you want to hear the other side of the story, come to Urbana.

The other subject is being dealt with also by an expert. I think we are very fortunate this afternoon to have two such talented speakers on the program at the same time. It says a great deal for the Ohio State University that any one school can corral such a galaxy of stars for the speakers.

The first speaker this afternoon is Jonathan N. Harris. Mr. Harris is a consulting specialist in direct cost accounting and overhead distribution. I think he is a refugee from an honest job, but he has an explanation. He was formerly a controller. You understand what I mean by refugee. He was controller of accounting at Cambridge, has CPA certificates of California and Massachusetts, and for many years was associated with Lieber Andrews Brothers.

Mr. Harris is credited with originating the concept of direct costing, his work dating back to 1933. I suppose we might ask him today if he wants to support that claim, or if that is Hermann Miller's statement. He is active in the Massachusetts Society of CPA's, in the Controllers Institute and in the NACA. He is a graduate of Dartmouth College, an author of numerous published articles, and he is a very well known speaker. And now Mr. Jonathan Harris will speak to us on the subject of "Product Line Earnings Under Direct Costing."

PRODUCT LINE EARNINGS UNDER DIRECT COSTING

By
JONATHAN H. HARRIS
Industrial Accounting Consultant
Cambridge, Massachusetts

Mr. Chairman, Conference Members and Guests: I want to express my appreciation of the great honor bestowed upon me by the Planning Committee of this Sixteenth Annual Institute on Accounting through its invitation to take part in today's program. I am especially grateful for the opportunity to present my views on the still controversial subject of Direct Costing — for the first time in the great State of Ohio.

Of course, my hope is that they will find wider and wider acceptance as time goes on. The never ending struggle of bookkeepers to live down the impressions created long ago by the green eye-shades and stand-up desks of the ancient accounting offices is still very real. Most people who work in the top echelon of the accounting function are still fighting to win a place at the council table where they can join with the representatives of research, production, sales and finance in making the important decisions upon which business success depends. Direct Costing would help them win.

I should like to begin serious discussion by asking some pertinent questions. Just what is Direct Costing? How did it get named? How does it differ from conventional standard costing? Why should successful companies bother to spend time and money investigating it? Why has the public accounting profession refused, so far, to give its approval of Direct Costing through the research bulletins of its chosen representatives, the Committee on Accounting Procedure of the American Institute of Accountants?

I believe I can answer those questions to the satisfaction of most open-minded men. Answer all of the questions, that is, *except the last one* which still has me completely baffled. A corollary of the last question is this: Why did the Committee, in its bulletin on inventory pricing, fail to recognize the practice of the largest industry in the world, upon the well-being of which everything else in the industrial world depends, especially in America? I refer, of course, to the STEEL INDUSTRY. It uses *only* the costs of materials and labor for inventory valuation purposes.

Now to answer my first four questions. Direct Costing is the name I chose back in 1933 for my own modification of the original principle of conventional standard costing. The name was intended to convey the thought that only costs which *rise and fall* with production of volume should be included in the definition of manufacturing cost.

This modification specially ruled out, and relegated to general overhead status, all manufacturing costs of a calendar time nature, on the ground that they are not affected materially by various levels of production activity and therefore are truly general in nature.

To state this another way, calendar time costs are those related to the problem of staying prepared at all times to make goods. Such costs continue to pile up even when no factory wheels are turning. They are in the same category as the salary of a company president. No company, as far as I know, has ever included any portion of its president's salary in manufacturing cost.

The historians among you will remember that conventional standard costing was first introduced by Charter Harrison in 1911. It made remarkable progress as a workable substitute for actual costing, because the results of industrial operations under actual costing cannot be stated with reasonable accuracy without taking physical inventory of all materials, work in process, and finished goods on hand at the end of a long period, generally lasting one year.

Mr. Harrison's theory was that inventory valuations of manufactured products could be established in advance of manufacture by engineering and time-study methods. The reasons of course were two-fold: first, to make the standards serve accounting-wise to measure the reasonability of the actual costs of production currently, instead of waiting for the annual closing of the company's accounts; and secondly, to make the standards available for sales pricing purposes on current basis.

Unfortunately, however, the Charter Harrison concept of 1911 failed to take into consideration one of the thorny problems of our free enterprise system. It overlooked the extreme difficulty of operating a manufacturing enterprise at an even pace day after day. It defined the manufacturing cost of an item as being the sum total of all expenditures related in any way to its manufacture — as distinct from, and not to be confused with, the research, merchandising, finance, and general administrative functions.

For the purpose of setting pre-determined, all-inclusive standard costs, it was and still is necessary to assume that the factory will operate at a constant normal level. This has to be done in spite of the fact that the assumed condition never really exists for twelve consecutive months. The only exception occurs when a monopoly product has won such customer acceptance and is of such a type that inventories can be built up *without risk* during seasonal months of low sales when customer buying drops off.

Because of fluctuating volume, the full standard cost technique, or absorption costing as it is now called, has a most serious accounting result. It mixes up accounting *for production* with accounting *for sales* in the Income Statement.

Why is this so? Perhaps I can explain the unfortunate result by telling you about my earliest experiences at Dewey and Almy Chemical Company of which I was Comptroller for a good many years, after starting there as a consultant in 1930. I was an ardent advocate in those days of the full standard cost absorption theory, and during the early 1930's had made a successful installation of absorption costing at Dewey and Almy.

However, its results continued to irritate the president at an increasing rate. Some men in this audience may know him well, and many of you will remember him as Rubber Director of the United States during World War II. His name is Bradley Dewey, and he still has the vigor and imagination which developed Dewey and Almy from a standing start in 1919 to the point where, long before his retirement in 1952, it had won world-wide recognition as a manufacturer of chemical specialties, that is, products made with the aid of chemical engineering know-how.

Dewey and Almy now operates 13 modern plants scattered around the globe. It makes 10 distinct and unrelated major lines, including machinery for application of some of the products in customers' plants. Some of the lines have important sub-divisions. Many of the plants make several of the lines. A few work exclusively on one line. Therefore, Dewey and Almy is truly a multi-product enterprise. This bit of information is important, I believe, because it means Direct Costing is not limited to less complicated operations.

True enough, the problems were not as large back in the early thirties. But late in 1933, when D & A annual sales were one tenth of the $35 million they are today, Mr. Dewey's dissatisfaction with the results of absorption costing reached the breaking point. He became the godfather of Direct Costing as the result of a conversation with me which ran something like this, except that I have softened the actual language just a bit and abbreviated it considerably:

DEWEY: "Suffering catfish! Do you mean to tell me that, with sales up more than one hundred thousand, profit is $20,000 less than last month?"

HARRIS: "Yes, Mr. Dewey."

DEWEY: "You're crazy, Harris! Or else your confounded accounting system isn't worth blasing powder. Why that sales increase should have boosted profit by at least $30,000, and yet here you show *a decrease* of $20,000! I know for a fact we haven't cut selling prices, and this P & L Statement shows selling expenses are not out of line. Your standard cost system is cockeyed if it produces results like this."

HARRIS: "Production was very low and the bad showing is accounted for by unabsorbed factory burden. It's in accordance with good accounting practice and Hoyle too, Mr. Dewey!"

DEWEY: "Then to h--- with good accounting practice and also Hoyle! I want an income statement that shows a profit increase when we make sales like these, and I don't give a tinker's dam what production is."

The complete conversation appeared in an article of mine published in the N.A.C.A. Bulletin of January 15, 1936, except that pseudonyms were used for the names Dewey and Harris. As you can guess, the conversation caused me to propose a new definition of manufacturing cost as a cure for the chronic deficiencies of absorption costing.

In effect, it said that manufacturing cost represents the cost of materials, labor, and only those other actual manufacturing costs directly incurred as the result of production activity. The new definition also affirmed that calendar time costs of a factory nature, incurred on a fairly constant basis, even when no goods are being produced, shall not be included in manufacturing cost, but instead shall be charged off currently to profit and loss when and as incurred.

The new definition must be accepted as realistic, and not open to question, if the manifest advantages of Direct Costing are to be obtained. Mr. Dewey and his top associates accepted the new definition as being both realistic and reasonable, and instructed me to put it into effect. I am sure you will agree that such acceptance by the highest echelon of management is vital to the success of any change in methods.

The results of the change at Dewey and Almy were startlingly good. The first result was that its Income Statements immediately began to show *higher* earnings in months of high sales, and *lower* earnings in months of low sales. Why did this happen? It happened because the increases or decreases in month-end inventories had no effect whatever on reported earnings.

This always follows under a proper application of Direct Costing because the mandatory new definition of manufacturing cost recognizes the dual nature of Factory Burden. This dual nature has become well known, at least to the advocates of Direct Costing.

The allowance for Factory Burden in a conventional standard unit cost really consists of only two basic kinds of manufacturing expense, even though a large number of cost accountants, who like to spend accounting dollars unnecessarily in splitting hairs, still insist that a third type of manufacturing expense, called semi-variable, must be recognized.

The two basic kind of manufacturing expense in my proven book are (1) those called direct expenses, because they are incurred only when goods are actually being produced, and (2) those which I refer to as *calendar time* cost since they are constantly incurred, even when no goods are being produced, in order to be prepared at all times for future production activity.

Failure to recognize the dual nature of Factory Burden has a bad result. It mixes up accounting for production and accounting for sales in the Income Statement, as I have said. This defect is not apparent to companies which make and sell the capacity of their plants month by month, and year in and year out.

But not many plants are in that enviable position. Practically all companies, because of economic and other reasons, suffer from feast or famine conditions. When times are excellent they find allowances for Factory Burden in their standard costs are too large. When times are poor, and good judgment says the factory should be operated at well below its rated capacity, the allowances for Factory Burden are too small.

Direct Costing *changes* such screwy results by excluding from standard costs the element of Factory Burden related to calendar time — by which I mean the fixed charges, and other factory expenses of a *standby* nature, which continue to build up even when the factory is shut down. Of course, the excluded charges have to go somewhere, since they have no way of getting into finished goods inventory and from there to cost of sales. Under Direct Costing they go directly to the Income Account in the same way as administration expenses.

One of the remarkable things about this change in handling is that the relatively stable nature of the excluded factory expenses immediately becomes apparent in a positive way. They stick out like a sore thumb in the Income Statement as *Production Overhead*, instead of being buried in an item called over-absorbed or under-absorbed Factory Burden.

It does not take long for the top management to realize it has also obtained a positive control over the out-of-pocket costs of materials, labor, and direct manufacturing expense. The difference between the cost of these items and the direct standard cost of goods produced stands out like a light-house in the Income Statement, against a side-heading called Manufacturing Variance. With intelligent standard direct unit cost setting and under effective administration, this single variance figure is so small that, for practical accounting purposes, the total standard cost value is generally equivalent to actual cost.

The top management, furthermore, is amazed to discover, just by reference to only two other figures in the Income Statement, that it has a perfect way of determining the amount of gross sales which has to be obtained to eat up all overhead costs of the month. The two figures are (1) merchandising margin realized on actual sales and (2) the total of all excluded overhead costs of all types, including not only indirect factory expenses of a calendar time nature, but also research and administrative expenses. Merchandising margin represents gross margin reduced by sales deductions of all types and by field selling expenses.

Even men not acquainted with the intricacies of cost accounting soon come to know that every dollar of gross sales above break-even point produces not just gross profit, but net operating profit in good hard cash at the rate of 30 or 40 per cent or whatever the merchandising margin per cent of the over-break-even point *sale* actually is. To determine the company's break-even point as of the statement date, all the leaders of the Company have to do is divide the merchandising margin per cent, as shown on the Income Statement, into total dollars of overhead costs.

Another boon to all hands is the complete elimination of plant *capacity* as a factor in the setting of standard direct costs. Absorption costing, on the other hand, first requires total plant capacity to be calculated. This means the making of an assumption that the factory will run continuously seven days per week and three or four shifts per day. What a tough problem this is, even in a one product enterprise! When several items of widely varying value are all made in the same plant the task becomes a guessing game of the largest magnitude.

But that is not all. Total plant capacity next has to be reduced to so-called normal capacity based upon another assumption that the factory will not run continuously, which indeed is to be expected. Here again NORMAL capacity depends upon guesses, pure guesses, as to how many days per week, and how many shifts per day, the factory will run during the future period for which the calculations are being made.

Another factor, already mentioned indirectly, is how the various kinds of goods manufactured will vary quantity-wise in the future. Just what will the production mix turn out to be?

In my judgment, all of these factors introduce the smells of gambling and horse racing into absorption costing—odors which seem far removed from good accounting practice.

Under Direct Costing plant capacity is of absolutely no importance whatever as far as unit standards costs are concerned. They are not affected by changes in the rate of production. This is proved by the figure called Manufacturing Variance in the Income Statement. It is truly negligible under proper administration of Direct Costing.

All of the excluded factory charges of a calendar time nature are controllable by *budgetary* means. Each responsible department manager makes his own budget, subject to top level approval. They all do this based on sales forecasts put out by the Merchandising Division, which first checks them with the Manufacturing Division to make sure that production facilities are large enough to produce the goods if the forecasted sales are obtained.

An interesting side-effect of this type of budgeting is that sometimes an over-optimistic sales forecast has to be cut down, or steps have to be taken to enlarge production facilities if the salespeople do a good enough job in selling the idea that the estimated future sales will be obtained. This can be done under absorption costing of course, but the whole job can be done a lot easier and for less money under Direct Costing.

The budgeting successes or failures of the department manager show up in a very few places on the Income Statement, arranged and combined into totals according to type, for comparison with the actual expenditures.

I hope I have made clear how an Income Statement under Direct Costing acquires new value as a modern tool of industrial management. Its great new value stems from the fact that properly established direct standard unit costs become as unassailable as the purchase costs of wholesalers and retail stores.

I hope we can agree that most accounting difficulties stem from trying to find out *where and why* operations are successful or unsuccessful, and that the difficulties grow like weeds, in geometric ratio, perhaps, to the number of new major lines put into the company's catalog.

However, the *where and why* questions are not difficult, if use is made of an overhead cost distribution plan I worked out years ago for Dewey and Almy Chemical Company. It was mentioned in simplified form in an article of mine published by *The Controller* in October 1948. I call it the "Past Performance Theorem." It is based upon another fact which does not seem to be open to question, namely, that from an account-

Schedule 1
Income Statement Under Direct Costing
By Major Product Lines
5 Months Ended May 31, 1593

	Total		Established Line		Doubtful Line		Growing Line	
	Dollars	*Per cent*	*Dollars*	*Per cent*	*Dollars*	*Per cent*	*Dollars*	*Per cent*
Gross Sales	7,687,988	100.0	5,625,530	100.0	1,350,203	100.0	712,255	100.0
Direct cost of sales	4,478,960	58.3	3,232,554	57.5	829,025	61.4	417,381	58.6
Gross Margin Above Direct Cost	3,209,028	41.7	2,392,976	42.5	521,178	38.6	294,874	41.4
Deduction:								
Loss on returned goods	37,620	.5	12,837	.2	8,401	.6	16,382	2.3
Policy allowances	5,970	.1	1,392	—	324	—	4,274	.6
Other customer allowances	6,751	.1	—	—	6,751	.5	—	—
Obsolete inventory items	5,004	.1	953	—	4,051	.3	—	—
Cash discounts allowed	35,914	.5	1,075	—	27,004	2.0	7,835	1.1
Transportation paid or allowed	86,904	1.0	31,887	.6	48,607	3.6	6,410	.9
Royalties paid	3,381	—	—	—	1,244	.1	2,137	.3
Total deductions	181,564	2.3	48,144	.8	96,382	7.1	37,038	5.2
Net Gross Margin	3,027,464	39.4	2,344,832	41.7	424,796	31.5	257,836	36.2
Selling Expenses:								
Divisional, excluding commissions	259,586	3.4	150,310	2.7	75,800	5.6	33,476	4.7
Commissions paid	75,999	.9	—	—	67,452	5.0	8,547	1.2
Total Direct Selling Expenses	335,585	4.3	150,310	2.7	143,252	10.6	42,023	5.9
Merchandising Margin	2,691,879	35.1	2,194,522	39.0	281,544	20.9	215,813	30.3
Overhead costs:								
Research and developmental	305,801	4.0	208,145	3.7	62,043	4.6	35,613	5.0
Sales administration	106,769	1.4	73,132	1.3	22,953	1.7	10,684	1.5
General administration	138,385	1.8	99,875	1.8	25,614	1.9	12,896	1.8
Production overhead:								
Building occupancy costs	129,579	1.7	63,006	1.1	22,278	1.6	44,295	6.2
Equipment usage costs	193,653	2.5	94,509	1.7	37,131	2.8	62,013	8.7
Mfg. Adm. & Non-pro. Depts.	317,499	4.2	157,515	2.8	89,113	6.6	70,871	10.0
Total production overhead	640,731	8.4	315,030	5.6	148,522	11.0	177,179	24.9
Mfg. variances from standard	187	—	(33,753)	(.6)	2,700	.2	31,240	4.4
Adjustment accounts	18,175	.2	11,251	.2	4,774	.3	2,150	.3
Total overhead costs	1,210,048	15.8	673,680	12.0	266,606	19.7	269,762	37.9
Operating Margin, Actual	1,481,831	19.3	1,520,842	27.0	14,938	1.2	(53,949)	(7.6)
Operating Margin, Budget	1,384,396	18.5	1,400,000	26.3	44,396	3.0	(60,000)	(8.6)
Favorable (Unfavorable)	97,435	7.0	12,842	8.6	(29,458)	(66.4)	6,051	10.1

To illustrate presentation of sources of industrial Operating Margin under the Direct Cost Plan for managerial guidance purposes.

ing point of view, industrial management performance is measurable in the best possible way by the results obtained in terms of goods produced and of goods sold over a reasonably long period of time.

The theorem is used to distribute to major product lines the segments of overhead costs of all types which are not amenable to direct charging or

SCHEDULE 2
INCOME STATEMENT UNDER DIRECT COSTING
DOUBTFUL PRODUCT LINE
5 Months Ended May 31, 1953

	ACTUAL		BUDGET		Favorable
	Dollars	*Per cent*	*Dollars*	*Per cent*	(Unfavorable)
Gross Sales	1,350,203	100.0	1,495,875	100.0	($145,672)
Direct cost of sales	829,025	61.4	931,930	62.3	102,905
GROSS MARGIN ABOVE DIRECT COST	521,178	38.6	563,945	37.7	(42,767)
Deductions:					
Loss on returned goods	8,401	.6	7,479	.5	(922)
Policy allowances	324	—	—	—	(324)
Other customer allowances	6,751	.5	5,984	.4	(767)
Obsolete inventory items	4,051	.3	—	—	(4,051)
Cash discounts allowed	27,004	2.0	29,918	2.0	2,914
Transportation paid	48,607	3.6	53,851	3.6	5,244
Royalties paid	1,244	.1	1,496	.1	252
Total deductions	96,382	7.1	98,728	6.6	2,346
NET GROSS MARGIN	424,796	31.5	465,217	31.1	(40,421)
Selling expenses:					
Divisional, ex. commissions	75,800	5.6	74,794	5.0	(1,006)
Commissions paid	67,452	5.0	74,794	5.0	7,342
Tot. direct selling expenses	143,252	10.6	149,588	10.0	6,336
MERCHANDISING MARGIN	281,544	20.9	315,629	21.1	(34,085)
Overhead costs:					
Research & Developmental	62,043	4.6	61,145	4.1	(898)
Sales administration	22,953	1.7	23,872	1.6	919
General administration	25,614	1.9	26,753	1.8	1,139
Production overhead:					
Building occupancy costs	22,278	1.6	22,340	1.5	62
Equipment usage costs	37,131	2.8	37,400	2.5	269
Mfg. Adm. and Non-production Depts.	89,113	6.6	90,747	6.1	1,634
Tot. production overhead	148,522	11.0	150,487	10.0	1,965
Mfg. variances from standard	2,700	.2	2,992	.2	292
Adjustment accounts	4,774	.3	5,984	.4	1,210
Total overhead costs	266,606	19.7	271,233	18.1	4,627
OPERATING MARGIN	14,938	1.2	44,396	3.0	($29,458)

To support figures in Schedule 1 for Doubtful Product Line. Similiar statements would be prepared for the Established and Growing Major Product Lines.

to handling under well-known methods which involve floor areas occupied by the various departments of the company, and the departmental locations of the investment in fixed assets. Of course, the company has to be properly and completely departmentalized, particularly with reference to major lines, to obtain the desired end results.

Perhaps the remainder of my formal address would be clarified if you will refer occasionally to the illustrative Schedule.

Consider the figures in the first column at the left. Gross Sales, Cost of Sales and Gross Margin offer no problems under any system of accounting. But under Direct Costing the figures take on new realism. An industrial company is in an enviable competitive position when it knows its inventory costs are as unassailable as the purchase costs of wholesalers and retail stores. In my estimation, that contribution to the art of industrial cost accounting is of inestimable value.

I have wondered sometimes how many people appreciated the significance of the early newspaper publicity on the Annual Report of General Motors for 1950. That was the year in which GM earnings reached a new all-time record of $834 million after taxes. Chairman Alfred P. Sloan and the then President Charles E. Wilson were concerned about public reaction. They included these words on Page 32 of their report to the stockholders:

> "It is well to bear in mind that GM's 1950 profits were earned in a year of exceptionally high volume. In high volume years profits rise more sharply than do sales. In years of poor business, on the other hand, profits fall more sharply than do sales. Profits fluctuate in this way because an important portion of costs is fixed and must be met whether business is good or bad."

I do not know what system of cost accounting is used at General Motors, but that statement by the 1950 leaders of the largest industrial corporation in the world gave me a real thrill. It stated so clearly the basic fact of our free enterprise system on which Direct Costing is based!

Why is the public accounting professon so loath to accept the Sloan-Wilson pronouncement and implement it to bring accounting results into agreement with the basic fact of capitalistic enterprise? I must confess, once more, I just do not know the answer to that question.

But I can answer the question put at the beginning of this paper: Why should *successful* companies bother to spend time and money on a change-over to Direct Costing after full investigation and study? The answer is they would spend fewer accounting dollars in every year of the future, and at the same time, end up with greatly improved earning powers, which brings me to the subject of my paper, "Product Line Earnings Under Direct Costing." The story is certainly different under absorption costing with questionable allowances for factory burden in cost of sales, which may be too large or too small because of the normal plant capacity problems already mentioned.

The various items called Sales Deductions and Selling Expenses also *are not problem* children, although they may vary widely between major product lines as illustrated on Schedule 1. They are all chargeable directly to the major lines benefited, and so allocation on some other basis is not involved.

Research and Development Costs do set up a bit of an allocation problem, but certainly not if expenditures of this type are incurred only against specific project code numbers. Identification of this type permits most of them to be summarized directly against the major lines benefited.

Only research expenditures of an exploratory nature, not related to existing lines of the moment, require different handling. My position with respect to them is that the earnings on existing lines normally provide the wherewithal to undertake studies which may or may not add new basic lines to the company's catalog. Therefore the old lines, which all came into being as the result of research expenditures of prior years, should take their proportionate shares of current exploratory research as part of the overhead costs of the old lines. This is where my Past Performance Distribution Theorem comes into use.

Unexpected advantages result from this reasoning. Jealousy of new lines is reduced and helpful interest in their success is promoted throughout the organization. When the new lines reach the sales stage and begin to account for increasingly larger portions of the company's total business, the old lines become more and more profitable. This follows because the general overheads shared by all lines are not ordinarily increased by the introduction of a new line. Consequently, the old line shares of such overhead are reduced under the Past Performance Theorem.

This theorem requires, for effective implementation, the preparation of two moving 12 months schedules of past performance. One covers cost of sales; the other covers the direct cost value of goods produced: both broken down by existing major product lines. The items of overhead cost, which cannot be distributed by any other positive means, go to the major lines in proportion to their respective shares of consolidated total cost of sales, or of total standard direct cost of production, for the 12 preceeding months.

Exploratory Research expenses, and also Sales Administration and General Administration expenses, go to the existing major lines, using the ratios disclosed by the moving 12 months schedules of cost of sales.

Production Overhead Costs are three types according to my thinking. *Building Occupancy Costs*, such as property taxes, fire insurance, and depreciation on buildings, and also housekeeping, watchmen, heating and lighting and the like, are allocated to all departments on the basis of departmental floor areas occupied. Some of the floor area costs end up and are included with the expenses directly charged to the non-production departments before making distribution of the latter.

The same handling applies to *Equipment Usage Costs*, except that, here, the allocation is on the basis of the original cost of the capital invested in machinery and equipment, broken down by departmental locations. Property taxes, fire insurance and depreciation on fixed assets of this type go to the departments which make use of them on this different distribution basis because the rates underlying these calendar time charges are different, especially in the case of depreciation. Therefore, all of the departments, particularly the production departments, if and when wide variations occur in the capital cost of the machinery and equipment employed, take widely varying shares of the Equipment Usage Costs.

Expenses of the *Manufacturing Administration and Factory Non-production Departments*, the next item on Schedule 1, go to the existing major lines on the basis of the moving 12 months schedule of the direct standard cost value of goods produced. This Income Statement item includes not only Manufacturing Administration, but also Factory Office expenses of all types such as clerks, timekeepers, office supplies, and allowances for heating and lighting. Also Shipping and Receiving Department expenses are included there.

At Dewey and Almy we tried using arbitrary rates, engineered somewhat after the manner of Interstate Commerce Commission rates, to pick up receiving and shipping expenses in the inventory and cost of sales, respectively, of specfic items handled. But it did not take long to discover how costly the results were in terms of the clerical force required to produce them. And the results were not any more reliable than those obtained by including the receiving and shipping costs in the totals distributed with the aid of the moving 12 months schedules of goods produced and of cost of sales. So the I.C.C. rate-setting method went overboard to stay.

I should not neglect to mention the item called Adjustments Accounts on Schedule 1. It represents the summary of many small accounts. Examples are the standard cost value of repetitive inventory test count gains and losses; container equalization accounts which take the unexpired portion of the purchase cost of returnable containers that make many trips to customers' plants before they wear out; purchase variance write-offs on raw materials, since under Direct Costing the differences between the pre-set standard costs of raw materials and the landed purchase costs are taken to Profit and Loss through Purchase Variance Reserves on a basis related to appropriate inventory turnover rates.

The Purchase Variances are controlled as far as possible through forward purchase commitments covering anticipated future requirements. It should be observed in passing that the Purchase Variance Reserve handling eliminates current variations in the prices of raw materials from the departmental Manufacturing Variances on goods produced.

The Past Performance Theorem is used to distribute the accounts in the Adjustment Accounts item that cannot be directly charged to existing major product lines.

The significant feature of my overhead distribution plan is that it reduces the task to a *clerical level.* Key men are no longer in position to influence the end results, perhaps unknowingly. Undeniably they are in that position when repetitive changes are made in the allocation methods to cover changes in circumstances which seem important at the moment. Clerks, certainly, should not be permitted to change the apportionments without executive approval, which eats up valuable time.

The job can be done by clerks under the formula methods I have described, and the results are truly equitable. In the long run it is impossible to get away from the leveling effects of production and sales mixes recorded over a reasonably long period of not less than a year. Each cumulative Income Statement, sub-divided into major lines as on Schedule 1 in your hands, appears almost as it would if every statement issued represented an entire year's activity.

Surprising results from a conversion to Direct Costing should be expected. Some lines long thought of as potential money-makers could turn out to be doubtful, or indeed actual money losers. Other lines, poorly thought of, might turn out to be real money-makers.

The most important result of all is that top management, under Direct Costing, soon gets in position to go after business and also to reduce expenses with rifle-like accuracy in the places that cost most. The blunderbuss methods of the past are automatically discarded in the process of acquiring greatly improved operating control.

Now I should like to point up my remarks with the aid of the demonstration blocks on the table.

The two columns of colored blocks on the table and in Figure 1 on the screen are identical in height, as you can see. The blocks were built to scale in the vertical direction. Each column represents either 100 per cent of the total gross sales of an industrial company, or 100 per cent of the sales price of an individual product.

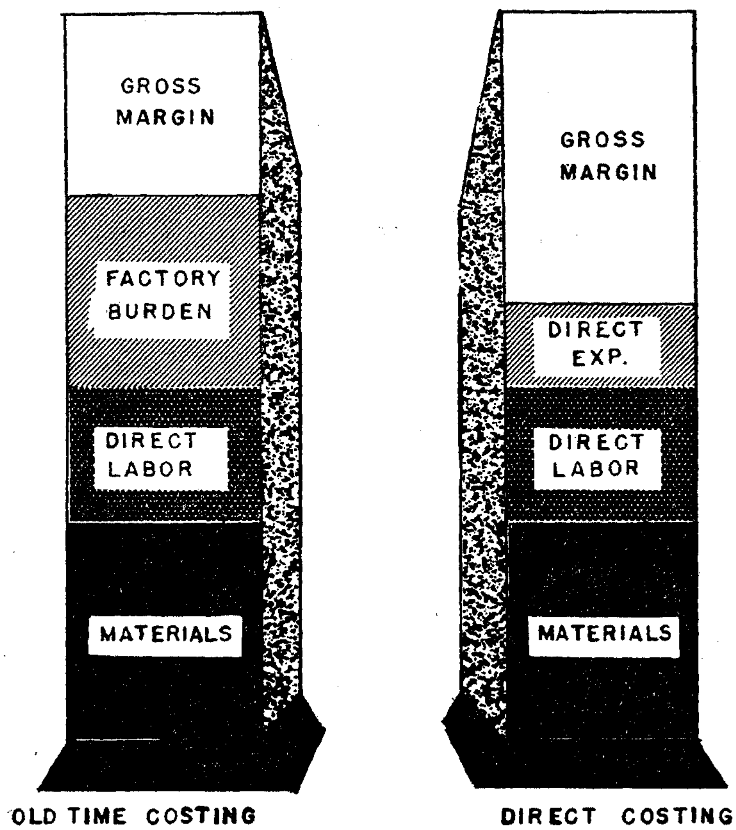

FIGURE 1

The column on your left, *labeled old time costing,* shows the basic four components of a sales price under Absorption Costing.

The column on your right illustrates the four basic elements of the same individual sales price *under Direct Costing.*

The two lowest blocks in each column are identical in size because the allowances for Materials and Direct Labor in any standard unit cost *are identical*, regardless of the system used. Together they represent 48 per cent of the total sales price, or 64 per cent of the standard absorption cost inventory price of the item.

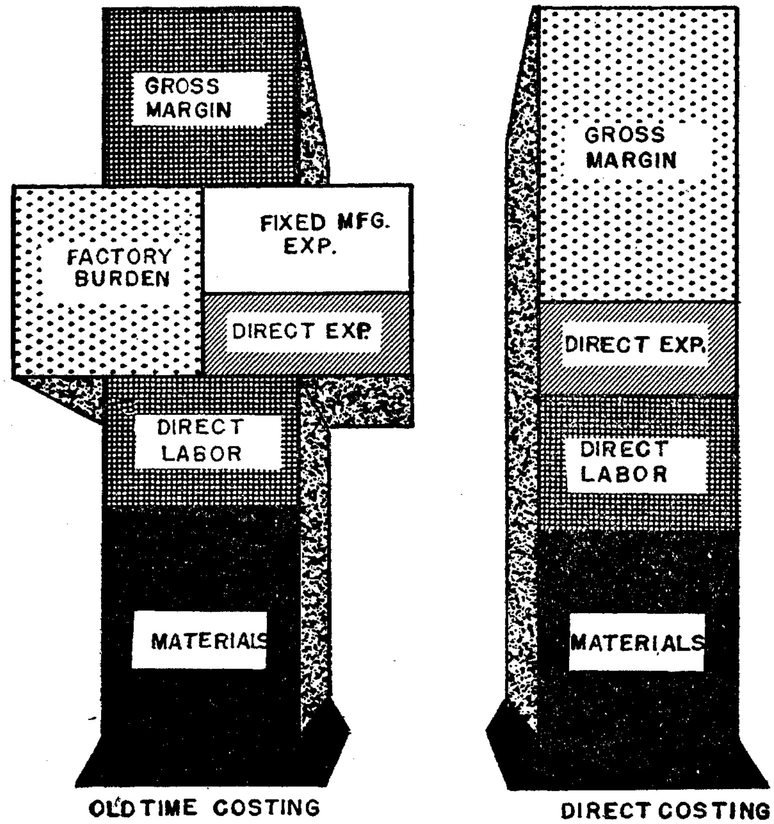

FIGURE 2

These percentages, as well as others I shall mention presently, are not unrealistic for a large number of enterprises, although they may vary up or down between industries, and between the individual products of a single company.

The troublemaker is represented by the gray Factory Burden block in the column on your left. Its height equals 27 per cent of the sales price, or 36 per cent of the inventory cost of the item sold. I call it the troublemaker because it really consists of two basic elements, as I said earlier this afternoon.

As shown on Figures 2 and 3, one of the two basic elements of Fac-

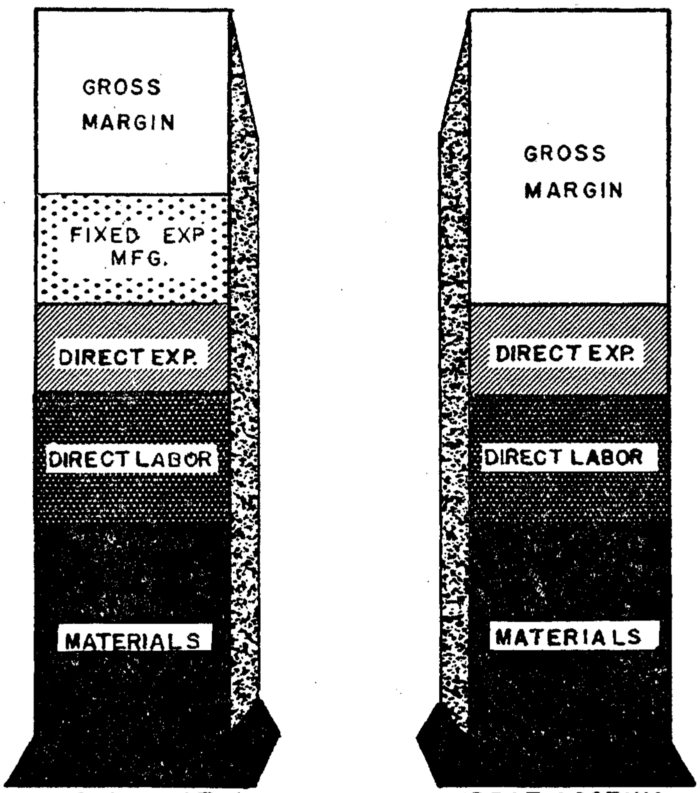

FIGURE 3

tory Burden, the yellow block, covers direct manufacturing expenses incurred only when the goods are being made. Good examples of the yellow block expenses are power, water, steam and compressed air actually consumed by production; factory supplies actually used up in the production process, such as hat strainers and screens in the chemical industry; normal maintenance; and spoilage incurred in production. The yellow block equals 12 per cent of sales, or 16 per cent of inventory cost.

The second basic element of a standard unit absorption cost is represented by the red block labeled fixed manufacturing expense. This element equals 15 per cent of sales, or 20 per cent of inventory cost. The expenses included in the red block are the calendar time costs which have either no relation, or very negligible relation, to production volume. They continue to pile up even under shut-down conditions. In this category are fire insurance, property taxes, depreciation, factory administration and office staffs, housekeeping, plant protection, and many other types of fixed manufacturing expense.

The red fixed expense block is a real troublemaker, due solely to the fact that its size is controlled by the guess-estimates of NORMAL plant capacity which have to precede the calculations of Factory Burden rates. Trouble develops because the size of the red block is realistic only when operations are conducted at the assumed level of normal capacity production.

When production runs *below* normal capacity in any month, the red block *increases* alarmingly in size, and shows up as unabsorbed Factory Burden in the Income Statement.

When production runs in excess of normal capacity, the red block *decreases* in size to the point of extinction, and beyond. Therefore, overabsorbed Factory Burden pops up in the Income Statement.

In the first case, unabsorbed burden reduces the gross margin realized on actual sales. In the second case, the company's operating profit comes not only from sales, but also from production operations in excess of normal capacity, because the actual costs of production are overstated through the device of capitalizing finished goods inventory at the lower normal capacity standard prices.

The advocates of Absorption Costing say, in effect, that this practice is o.k., although it is an undeniable fact that profits on excessive production cannot be realized until the inventory goods have been sold for a lot more than it cost to make them.

The white gross margin block in the column on your left equals 25 per cent of gross sales, or 33⅓ per cent of the old time inventory cost.

Now, as you can see, in the column on your right, the red block has been eliminated, with a resulting increase in the size of the white gross margin block, which represents 40 per cent of gross sales, or 66⅔ per cent of the standard direct inventory cost value. This cost value is the sum of the brown Materials, green Direct Labor, and yellow Fixed Manufacturing Expense blocks.

It is indeed significant that every single block in the Direct Costing column on your right is absolutely fixed percentage-wise for any single product manufactured and sold. It follows, therefore, that the four elements are also fixed dollar-wise, so that the company's Income Statement, in effect, results from the simple procedure of multiplying quantities of the various items actually sold by the dollar components of their selling prices.

Now if we may have Figure 4 we can see what the larger white gross margin block pays for on a break-even basis, as illustrated on its back. The four broad items paid for, as described earlier this afternoon, are Selling Costs, Fixed Manufacturing Expense, General Administration and Research Expenses.

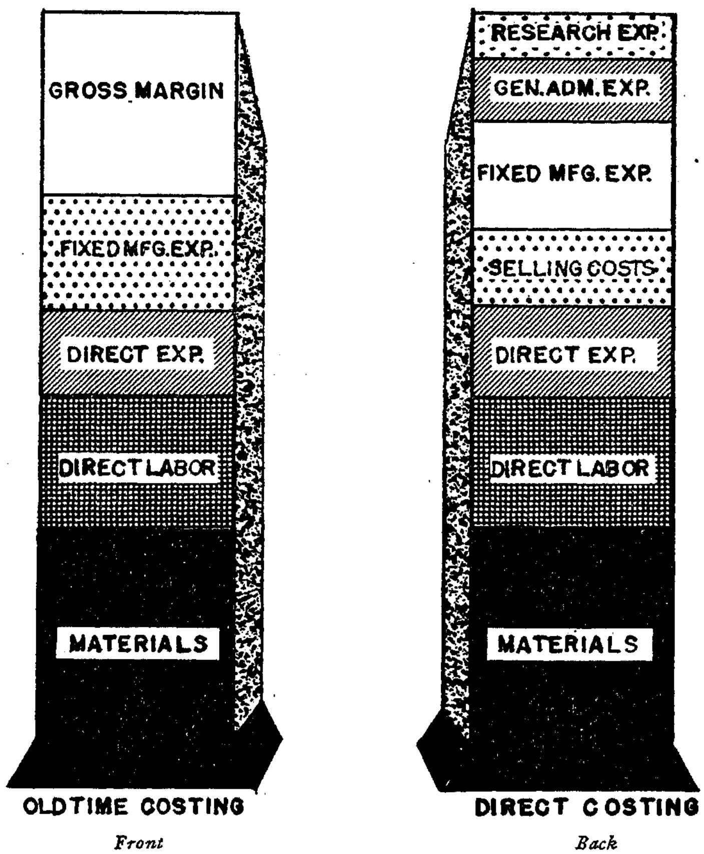

FIGURE 4

I think it can be agreed that the top three of these categories are really fixed dollar-wise for any semi-annual or annual accounting period because they are budgeted ahead of time by all well-run enterprises operating under Direct Costing. They do not change materially, regardless of the degree of success in attaining the sales forecast.

The fourth item from the top, selling Costs, tends to go up when sales are down and, conversely, go down, percentage-wise, when actual sales exceed the forecast. This happens especially when field representatives travel and work on a straight salary basis, instead of under a strict commission plan.

Figure 5 shows what happens to the items paid out of gross margin when the company fails to break even and therefore loses money. See

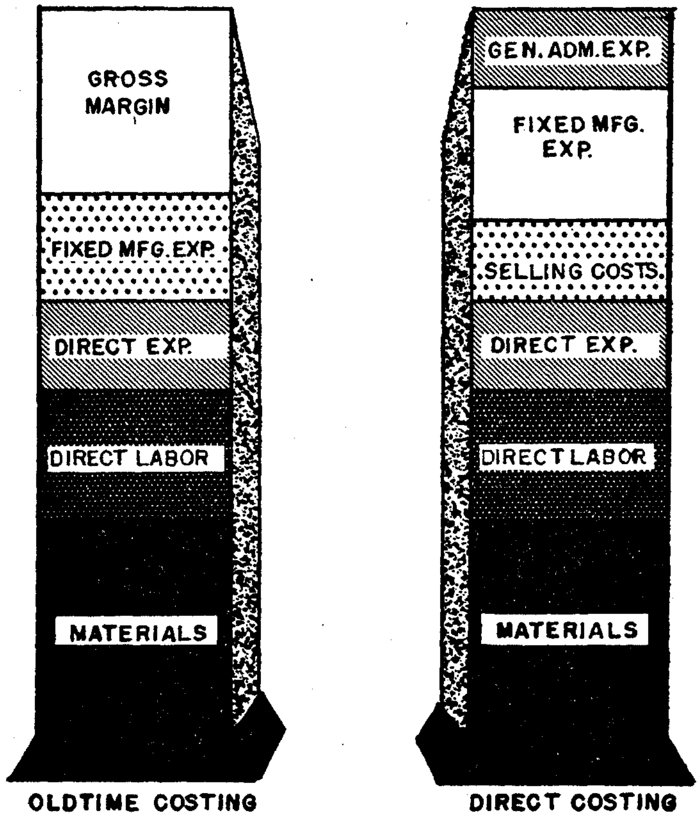

FIGURE 5

how much larger the elements are percentage-wise, even though the dollars spent have not changed! But note that the inventory components represented by the brown, green, and yellow blocks, have *not* changed percentage-wise!

The last Figure 6 shows the relationships when the company makes real money. All of the four elements paid for out of gross margin are greatly reduced percentage-wise, but not dollar-wise. And, in addition,

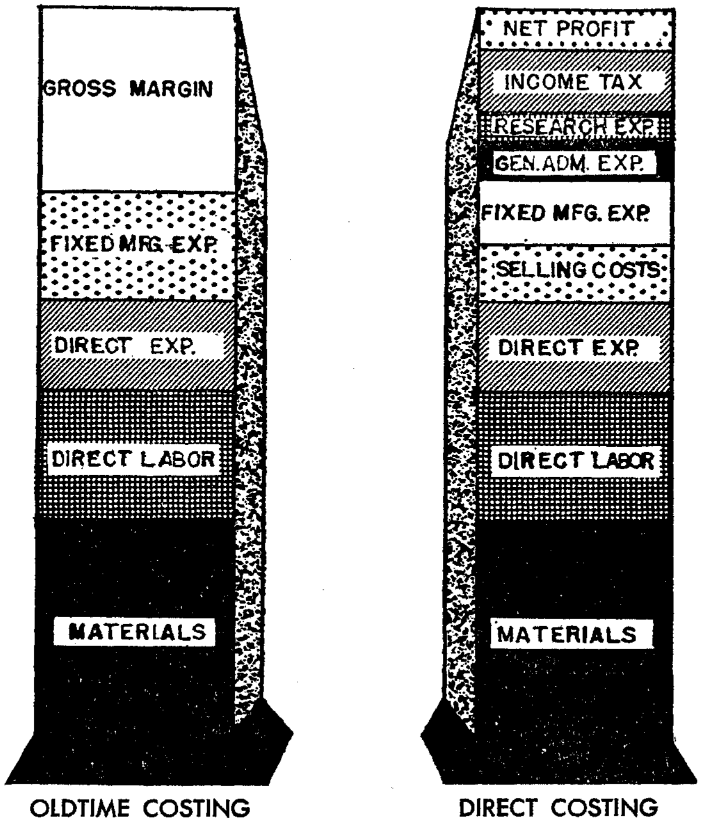

FIGURE 6

two new elements appear; namely, Income Tax and Net Profit. Nobody has discovered how to avoid splitting Operating Profit with the government.

Ladies and gentlemen, that completes my presentation, although a number of details have not been mentioned because of time limitations. I hope you will appreciate how my Overhead Distribution Plan makes possible accurate determination of the sources of Operating Margin by major product lines, and thus provides greatly improved managerial controls with the aid of Income Statements like the Schedules 1 and 2 in your hands.

In my judgment, the great value of the Overhead Distribution Plan, with its formula reliance on the use of direct charging, floor areas, location of plant investment, and past performance in terms of goods produced and of goods sold, will be quickly recognized by all who give it a fair trial. It truly is a wonderful new tool of modern industrial management which costs less money to operate than any other form of accounting in existence today.

CHAIRMAN SMITH: Mr. Harris, thank you very much for a very fine talk.

Our second speaker is Mr. Arthur B. Foye, senior partner of Haskins and Sells of New York City. He is President of the American Institute of Accountants; is on the Far East American Council of Commerce and Industry; has been active in the New York Society of CPA's, is a member of New Jersey, California and Pennsylvania; and is a graduate of New York University where he has taught.

Of particular interest to me is the fact that in 1916 he came here to Columbus as a member of the group to organize the American Association of Instructors in Accounting. So it is my pleasure to introduce one of the grandfathers of the American Accounting Association, who will speak on the subject of Professional Standards. Mr. Foye.

PROFESSIONAL STANDARDS

By
ARTHUR B. FOYE,
President, American Institute of Accountants; Partner, Haskins & Sells, New York, N. Y.

Mr. Chairman, members of the sixteenth annual Institute of Accounting. Of course, it is a privilege to be at this meeting, and to be here representing the American Institute of Accountants.

Ohio State has always been in the forefront of activities connected with the advancement of education, and with the advancement of the profession. This Institute, for example, is one of them, because it was, to my knowledge, the first to start these Institutes which have now spread over the country. It also was the first to start the program of interneship effectively. It was likewise, first in establishing a Hall of Fame for Accountants.

Mr. Smith has just referred to one first that they had in the past and about which I am slightly nostalgic. Thirty-eight years ago, Ohio State, in the City of Columbus, was the place where the American Association of University Instructors in Accounting was founded. From that grew the American Accounting Association. I was at that meeting. As far as I know, there are perhaps only two persons in the room who were also at that meeting. One of them who will be honored tonight is Hiram Scovill of Illinois. Another one of them is Gould Harris, who was a professor or assistant professor here at the Ohio State University, when that organization started, and was induced as a result of it to go to New York University, where he has remained during the rest of his academic career. There are other names that come to me who are well known in the profession: Fayette Elwell, Henry Rand Hatfield and John R. Wildman. So I do have that slightly nostalgic feeling about Columbus when I think back to those days almost 40 years ago.

I may say that as President of the American Institute of Accountants, because it is in that capacity that I am here, that I have been having a very interesting time getting around and meeting people and making speeches.

In this matter of making speeches they are always rather difficult, and the American Institute was perfectly willing to allocate a ghost writer of speeches, but I have a prejudice against that. Something like the prejudice that Heywood Broun, the columnist on the old *World* in New York had about them, particularly political speeches which did not really present the views of the speaker, and were obviously ghost written.

It is related that one time Warren Harding made such a speech, and he went through with the usual pompous statements, the usual cliches, perhaps he had not read it before the meeting. When it was done, he sat down, and there was polite applause.

Then Heywood Broun could not resist it, but jumped up and shouted, "Author, author!"

Of course, as I say, this matter of ghost written speeches, if handled properly, can work out well. I have told some of you the story that is related of Charley Schwab, the great steel man. Schwab was an able speaker and a great actor on the platform. He was speaking at the annual meeting of the American Iron and Steel Institute.

At the table was a vice president of Schwab's company, who had been assigned the task of writing the speech. The man had spent three or four weeks working on it very hard and thought it was a masterpiece. During the dinner time he talked to Clarence Randall of Inland Steel and others present and said "When Mr. Schwab comes to this point, listen to that, because that is going to be very good. When he covers this subject, that I did go into exhaustively, you will find that is excellent." And so forth.

The time came for Charley Schwab to get up and speak, and he had in his hands a sheaf of papers, and as he looked down over the audience, he said, "You know, you are my friends. I just cannot possibly read a prepared speech." And he tore the speech up and threw it on the floor. This poor vice president sitting there saw four weeks' work go.

Then Charley looked out at the audience, and he said, "My friends, I am going to talk to you from my heart." Then he went ahead and delivered that speech word for word. It can be done!

But I do not have his memory, and I do have Heywood Broun's dislike of ghost writing.

The subject that I have is one of "Professional Standards." I talked on this subject in Nashville last Monday. And while the subject is the same, it is not the same speech.

You know, the same Heywood Broun tells of Fannie Hurst, one of our well known, fascinating novelists. Fannie Hurst had been very stout, and then slimmed down, as young ladies do now. One day he was on the street and passed Fannie Hurst and did not recognize her. After she had gone by, she called to him, and said, "Heywood, don't you recognize me? It is the same Fannie Hurst." He turned around and looked at her. "Yes," he said, "it is the same Hurst, but not the same Fannie."

Of course, professional standards are not set by any one person, or by any one organization. They have their roots deep in the past, sometimes so obscurely that you do not recognize the existence of those roots. The surface indications do not always bring them to mind.

There is an analogy that I think is particularly apt in Central Ohio, an analogy in Geology. Some of you may know that many, many years ago, before the Ice Age had covered this area, there ran through Central Ohio, not quite through Columbus, but through Springfield, a river which was really the master river of this part of the continent. The Mississippi was merely a tributary of that river. It was that river which created the great delta, the credit for which we give to the Mississippi.

The geologists called this ancient river the Teays, from a little crossroads station in the valley between Huntington and Charleston, through which that river once flowed.

That river they found had really carved the landscape of this interior part of the United States. Its sediment had filled the section of the Gulf of Mexico, which in those days extended as far as southern Illinois.

But these glaciers of the Ice Age, which perhaps were once 10,000 feet thick over this area in which we are now sitting, crept down and filled the Valley of the Teays with glacial debris and sediment, and the river ceased to exist, except where some river such as the Ohio still occupies part of its valley.

A million years have passed since the first sheet flowed over this area and erased that river, but of course, that million years is only a small fraction of the time that the River Teays had actually been the great river in this area. It is gone in a sense, but more importantly, the greater portion of that river still carries its waters across Ohio and across Indiana and across Illinois underground. Rain water and melting snows percolate into those loose sands and gravels that fill that buried valley, moving as ground water along the old channel, and so the Teays River is not gone. Its waters still flow slowly underground, and the subsurface water is drawn to supply cities and people who never heard of it.

So very many of these professional standards come from age-old customs, many of which are forgotten, and they come from age-old ideals deep in humanity. I think it is for that reason that these standards have their universality, and have their breadth, and they apply to all the professions which are represented here today.

Physically they have as foundations these broad things, an understanding of the social and economic structure. They have a perception of moral values, the heritage of ethical culture and an understanding of basic human relations.

Of course, the word "profession" has had a connotation in years past of a group of people separated from others. That, however, is not true today. There are not the few professions of several hundred years ago, but many professions, and whether a group is a profession depends upon the standards and on what it does, and not merely on some past record of its being a learned profession.

What is a profession? Professor Sanders, in a book which he wrote on the profession, says it is this: "It is where the practitioners by virtue of prolonged and specialized intellectual training, have acquired a technique that enables them to render specialized service to the community. They develop a sense of responsibility for the technique in which they manifest their concern for the competence and for the honor of the practitioners as a whole, a concern that in some professions is really shared by the state.

"These practitioners build up associations, and upon those they erect machinery for imposing tests of competence, and enforcing the observation of certain standards of conduct. And through these associations they assume professional obligations."

So we have, if I may restate that briefly, a profession with the necessity for specialized intellectual training, and the acquisition of a technique—a specialized technique which can be used in service to society. We also have formation of associations, and in those associations the duty to impose tests of competence which, in a sense, include the matter of educational standards, as well as to enforce standards of conduct which, in a sense, are the codes of ethics and the rules of professional etiquette, and then they assume certain professional obligations, both to the public at large, and to each other, with a very real sense of responsibility underlying all of it.

On educational standards, there are the standards of general education and specialized education. We had a very interesting discussion at lunch time with Professor Fertig on this matter of general and specialized education. I think we all recognize that a professional man should have a specialized education. But he should also be an educated man in the broad sense, if he is to play a proper part in the application of his technique to the society in which he lives and works. So not only should he have technical knowledge, but he should have initiative and resourcefulness and self-reliance. That really comes out of a breadth of education.

The test of professional competence in an association or in a profession is sometimes shown by the absence or presence of a back door into a profession. I think the more real a profession is, and the higher its standards, the more there is an entry in one way only and not through back doors. Mr. Broad and I have had experience with a back door in New York called the Oliver Bill, and there are other back doors of that kind.

Thornton Douglas, one of our very able accountants in California, tells a story along that line. Irving Weeks, one of the ablest of California's attorneys, went to California in its early days, after having been educated in the East. Admission to the bar in California in those days was through an oral examination before a judge.

As Weeks sat there waiting, he realized more and more that, to this stern old judge, the law of California was based on the Spanish law and not the law that Weeks had studied, the common law, and his heart sank as, one by one, these candidates were given a pretty thorough grilling by the judge.

Eventually he went forward, and the stern old judge thumbed his application and read it, seemingly with interest. Then this colloquy took place.

The judge said, "Is your name Irving Weeks?" "Yes sir." "Are you from Virginia, sir?" "I am, sir." "Do you come from that Weeks family in Richmond, by any chance?" "I do, sir." "Did you graduate from that noble institution founded by Thomas Jefferson, that great University of Virginia?" "Yes, sir." "Did you, by any chance, study under Professor Armitage, that distinguished gentleman, scholar and jurist?" "Yes, sir." "You have passed your examination, sir. Next man!"

Of course, on this subject of ethical standards, there are codes in all professions. Perhaps the oldest of the codes, as they now exist, is the one in the medical profession, which is in about the same form as it has been for one hundred years. The Hippocratic Oath of the doctors goes back thousands of years.

The legal profession has been showing a great deal of concern with sound codes of ethics. According to Professor Harno, who wrote an excellent book on legal education in the United States, a survey in 1951 showed that some 39 out of 87 law schools which replied to a questionnaire had codes of ethics.

The American Bar Association and the Association of Law Schools set up a joint commission to work cooperatively within the field of professional ethics, both to encourage courses in professional ethics, and to make a substantial contribution to the improvement of legal codes and standards. I think they are generally in the legal profession deeper than the one about which Thurman Arnold tells.

He went to Montana to practice law, and he found out there an old Attorney General, who was a fairly salty character and loved to give advice. Thurman went around to see him, and when he talked with the old judge, the old man said to him, "Did you ever have a course in ethics?" "No," Arnold said, "we did not think that was necessary at Harvard." "Well, I am happy to hear that, because I can give you in one sentence all the legal ethics that you need to know." Arnold said, "That would be very interesting. What is it?" "Well," the old man said, "remember this. When you are involved in litigation and it becomes necessary for somebody to go to jail, be sure it is not your client."

What are these ideas of conduct that underlie all professional codes of ethics? I think they are, first, the obligation to serve, and that is perhaps highest in the medical profession than any other profession: In their willingness to serve whoever comes to them.

Second, comes professional secrecy; that is, the duty to keep clients' affairs confidential. In that, I think the accountants are equal to any.

Third is financial disinterest or independence, and again the accountants have made quite a fetish, perhaps urged a little by the SEC, in this matter of independence and financial disinterest.

Fourth is the avoidance of price cutting and advertising, or the more subtle vice of ingratiating oneself with another's clients.

Fifth is the matter of covering. By that is meant having some unprofessional person do the work, whether it is medicine, law or accounting, and then covering that work by the use of some professional man's name.

And consider the avoidance of corporate form. I think the accountants live up very squarely to these ideals. But I do want to say that we must never forget that all codes of ethics are really the expression of character, the expression of the inner man, and that they can be simplified to that.

The third thing I spoke about is the matter of the obligations of a profession. These are professional obligations which are assumed very largely through the associations which are formed in a profession. Sometimes these codes or standards cover both codes of ethics and professional obligations.

I was interested recently in seeing that one that had been posed by the distinguished scientist, Harold Oakley, who gave these simple things as the important ones in connection with the code for scientists. He said, "There ought to be a sharing of new knowledge. There should be an obligation to publish important findings. There is the necessity for veracity and a maintenance of integrity. And one that is peculiar to science, a recognition of priority. And again, one perhaps peculiar to science, the striving for refinement of method."

But see how they are interwoven. We have many of those same things as our obligations. I think we can say the obligations of a profession, apart from that basic obligation of rendering effective and efficient service, are approximately following:

1) To encourage the development of educational facilities.
2) To raise educational and technical standards in the profession.
3) To encourage the study of professional matters through journals or through institutes such as this, or meetings where information is exchanged.
4) To make these technical skills available to society.
5) To contribute broadly through service to the community and to national life.

I should like to dwell a little more on that last item in the professional obligations. During the present century, the legal profession has been extremely active in encouraging the teaching in the law schools of the duty of lawyers to render public service. I think, to that teaching and to the practice of that teaching, the legal profession owes its present high standard.

The service to business by certified public accountants has made them the fastest growing profession in the country. As you heard Mr. Carey say at noon, it now has almost 24,000 members, as compared with 6,000 when the first Institute was held, or with about 2,500 members when the American Institute and the American Society came together. Although they have been the fastest growing, accountants generally have been too busy rendering service to their clients to do all that they should in the matter of public service.

I know that there is more use of public accountants in public service, in governmental service. The sweep is perhaps coming in our present day. We have, among other things, the appointment of T. Coleman Andrews, a certified public accountant, as the Commissioner of Internal Revenue. We have the recent appointment of Percy Brundage as the Deputy Director of the Budget. We have seen in the last year the two people like Maurice Stans, who is the nominee for President of the American Institute next year (devoting many months in Washington to the streamlining of the accounting department of the Post Office), and my own partner, Edward Kracke, who has spent the better part of two years working with the House Appropriations Committee, to help them reduce the budget.

In perhaps a little more united capacity, the Tax Committee of the American Institute of Accountants, headed so ably by Mr. Seidman, whom you will hear tomorrow, has rendered invaluable service to the House Ways and Means Committee, and to the Senate Finance Committee in connection with the present tax bill. No association and no organization has approached the excellence of the presentations, or given as much help to those committees as our Tax Committee of the American Institute of Accountants.

In our complex industrial economy, the importance of taxes and the importance of government finance will steadily grow. As I said, our taxes are not being reduced, although I think it was one of your Ohioans, Charles Kettering, who said that perhaps it is just as well we do not get all the government we pay for!

There is this ever greater need for accountants, and I do not mean thereby to take all of the credit for public accountants, because private accountants are doing equally fine things. Roland Hughes, the former controller of the National City Bank of New York, is now the Budget Director in Washington. It would appear that the accountant generally is being used, but he should be, because it seems to me that the accountant, more than anyone else, is trained to think objectively about financial facts, and that kind of thinking is needed in all areas of government. Most of us, whether we are in private work or professional work, should be more conscious of this need in the communities in which we live, and the nation in which we live, and be prepared to render that service.

All of the professions gathered here, namely: the National Association of Cost Accountants, which has its educational program, its codes, its professional obligations; the Controllers Institute of America; the American Accounting Association; the Public Accountants of Ohio; the Ohio Society of CPA's; the American Institute of Accountants; have these same broadly common professional standards. They are the desire to improve the position of the profession, to improve educational facilities, to help people do better work in it, to represent themselves to the public in the professional areas, with the underlying codes of ethics based in all these associations on high character, and with a recognition of these professional obligations, both to themselves in the profession and to the public.

I think as we go on, that these associations will all continue to develop those codes and standards, so that when the 32nd Institute is held here in Ohio, they can look back to a great growth in the quality of the work and the professional standards of these organizations. Thank you very much.

DISCUSSION

CHAIRMAN SMITH: Remarks about standards remind me of one of the answers to a CPA examination. The question first set forth a rather elaborate and confusing set of facts, several of which were rather thoroughly entangling. One was, could the public accountant undertake an audit of his company? Would it be ethical? One of the candidates answered that he would consult his attorney.

We have our two speakers, Mr. Harris and Mr. Foye, if some of you people have questions.

MR. ROGER GIFFORD (Van Dorn Iron Works, Cleveland): I should like to ask Mr. Harris a question. The question I have concerns itself with the moving average theory that you speak about in allocating overhead. I am wondering if the conditions were such that you were unable to tell that a product line was either a growing line, or it was an established line. Let us say that we had lines A and B. Would you not be penalizing line A for an increase sales volume if you allocated these overhead costs on the moving average theory?

MR. HARRIS: The question involves a variety of using the moving average theory to distribute overhead cases, in the case of a new product line, which may or may not be successful, and is taking up a very small portion of the sales currently. What is the propriety of it? Is it unnecessarily penalizing the old line? Was that the substance of your question?

MR. GIFFORD: No, I would not say that one is new and one is old. Line A and line B are both established, but line A in a certain given year shows an acceleration in sales. Now, if we allocate the overhead on a moving average basis, we are therefore charging that line with more overhead, and therefore penalize the profit picture of that line.

MR. HARRIS: You understand, of course, where you had two lines, A and B, one of which accounted for a larger portion of sales in a current year than it had in the past, that you penalize it by this moving average, because it merely takes a larger portion of the overhead. I should say that in the case of established business I would include more than one year in distribution figures. In fact, I propose in my own company that you might go two or three years in order to level out the effects of variations in sales volume between lines and the approved value.

You can take the figures and put them on a graph paper, so that the amount of overhead which goes to the various lines really goes in proportion to the number of months you take into the distribution base, and in the last analysis, whether line A or line B happens to be big this year, does not make a bit of difference in the cost of time. The company is getting its profits out of both products A and B, and if the general overhead cannot be allocated in any other way, allocated in the way I suggested, you get an equitable and comparable result.

CHAIRMAN SMITH: Are there other questions?

MR. ROBERT SEILER (Student, The Ohio State University): Mr. Harris, to what extent has the Internal Revenue Department recognized the inventory valuation under Direct Costing?

MR. HARRIS: The question is, to what extent has the Internal Revenue Department recognized the existence of Direct Costing? I think you will have to get Coleman Andrews to work on that. Actually, they have not done anything more than the American Institute of Accountants. My nearest approach to it is having read of Mr. Wayne Keller's talk in one of the recent year books, NACA annual convention, where he said he knew of three companies in the Middle West which had adopted direct costing, with the permission of the Internal Revenue Department on this basis. One of them permitted the beginning slug, excluding factory charges that you have when you reduce the beginning inventory, but permitted write-off over a period of three years, and another five years, and a third over a period of ten years. They probably had about $10 million in the slug account.

Actually I think that it requires pressure on the part of the industry which makes use of Direct Costing on an increasing scale through a company to bring pressure, the same as they brought pressure, to bring about with the aid in this case of the public accounting profession of the lasting first dollar. It took nearly ten years to get the lasting first element. The trouble is that people wanted to install the idea as soon as they heard of it. It got backed off the map, because they thought prices were going down lower than they were. By the time ten years had expired, prices are way up, and it is not particularly advantageous from a tax viewpoint to do it now.

To answer your questions specifically, it takes a bit of selling in Washington, I think, before we are permitted. You can, however, still go to direct costing and get all the benefits and competitive advantages of it from a price setting viewpoint by any one of several easy methods, adjusting the inventory you start with, to what it should be at the end of the year, and do it only for taxable income, so you have the same amount of taxable income as though you had not made a change-over.

We have had a most interesting session this afternoon. I am sure that I speak for all of you in saying that we are greatly indebted to Mr. Harris and Mr. Foye for these very, very fine speeches they have given us.

I suggest that we now stand adjourned until 7:00 P. M.

FOURTH SESSION

THURSDAY, MAY 20, 1954—7:00 P. M.
The Ohio Union — West Ballroom

Presiding:

DEAN WALTER C. WEIDLER, *College of Commerce and Administration, The Ohio State University*

Introduction of honored guests

Paper: "A Bigger Pie Has Bigger Pieces"

CLIFFORD F. HOOD, *President, United States Steel Corporation, New York, N.Y.*

Presentation of distinguished accountants to The Accounting Hall of Fame

FOURTH SESSION

Introductory Remarks

Dean Walter C. Weidler: Some years ago I happened to be on a fishing trip in Canada, and caught the trout of a lifetime, a beautiful four-pound brook trout. When I returned to Columbus, with becoming modesty I did not tell more than 400 or 500 people about it, but among my confidants was my dear friend, the late Thomas L. Kibbler of this faculty.

At long last I got the trout from the taxidermist, and told Tom it was hung on the dining room wall. A few evenings thereafter, the doorbell rang, and I went to the door, and there stood my dear friend, Tom, who looked at me very solemnly and said, "Walter, I have come to see the trout."

Without further discussion, I took Tom into the dining room. He crouched down and looked up at the trout, then stood on tiptoe and looked down at the trout; he stood to the left, and then to the right of the trout, and turned to me with great formality to ask, "Walter, how much did you say that trout weighed?" "Four pounds, Tom."

Then he went through the inspection all over again, and finally he turned to me and said, "Walter, you could have lied a pound to a pound and a half."

Speaking of sizes and magnitudes suggests a story which turns around the wise, engaging personality of the late Christopher Sherman, long a distinguished member of our Engineering faculty. He happened to be a member of the Torch Club, and when he was put on the program he wrote a paper entitled, "Old Man River."

It seems that Chris was a civil engineer, and had done important engineering work, attempting to help control the Mississippi, and so he prepared a very interesting paper. He emphasized, in the course of that paper, the magnitude with which the engineer who would attempt to cope with Old Man River had to deal.

At the end of his paper, he said something like this, "Gentlemen, you see that the engineer who is attempting to put a control on Old Man River must deal with some very impressive magnitudes." The chair opened the subject for discussion, and a mathematician in the group arose and said, "Gentlemen, Professor Sherman has given you what seemed to him to be some impressive magnitudes. They really do not amount to much. Let me give you some real magnitudes."

He stepped to the blackboard and said, "Let me give you some astronomical magnitudes." Then he launched into a fifteen-minute talk. At the long conclusion of his remarks, the chair turned to Professor Sherman and said, "What do you have to say to all of this?" Whereupon Professor Sherman said, "I am sorry I even mentioned it."

Speaking of sizes and magnitudes certainly reminds me of things that I wish to mention this evening, and they are important to my colleagues and to the College, and they have very substantial magnitude, indeed. Certainly I am not exaggerating when I say my colleagues and I view the scene this evening with a deep sense of gratitude and satisfaction.

We are grateful because, in our judgment, this is as distinguished an accounting audience as has ever come together in this State. We are grateful because we have with us this evening the representatives and officers of seven national and state accounting organizations. The list includes six presidents, the organization of the American Accounting Association, the American Institute of Accountants, the Controllers Institute of America, the Institute of Internal Auditors, the National Association of Cost Accountants, the Ohio Society of Certified Public Accountants, and the Ohio Society of Public Accountants.

I take time to name these associations because of our indebtedness to their officers, which is so great. They have been stalwarts in the promotion of these conferences. Our heartfelt thanks to these and to all who contributed so generously to the program.

We are grateful that we have with us members of our Board of Trustees and a goodly number of representatives from the University administration. In my 39 years of service in this University, I have never known a Board of Trustees or a University administration that is more forward-looking with reference to University plans and needs. It augers well for the future of this University. Please believe I make these observations in all sincerity.

I am personally thrilled by the determination to make this a greater University. My only regret is that a compelling engagement prevented President Bevis from being with us this evening, because he had such a very vital part, indeed, in this leadership.

We are grateful because we have the honor of presenting a most distinguished speaker, President of the U. S. Steel Corporation. We are also grateful for the opportunity of doing honor to four great accountants by signalizing their election to the Accounting Hall of Fame.

May I express my personal pleasure at this reunion with so many good friends of long standing, and my personal gratitude for the privilege of working with Professor Miller and his predecessors in the chairmanship of the Accounting Department, as well as their colleagues. I have found great satisfaction, indeed, in these associations.

Before presenting those at the speaker's table, may I direct your attention to a table immediately in front of this rostrum. Seated at this table are four ladies whose husbands are being honored by the election to the Accounting Hall of Fame. Also seated at this table is Mrs. Clifford Hood, the wife of the speaker of the evening, and at that table there is also seated their hostesses. I now have the privilege of presenting them to you.

May I first present Mrs. Howard L. Bevis, the wife of our good President. Will you take a bow?

May I present Mrs. Hiram T. Scovill, whose husband is being honored this evening.

May I also present Mrs. Jacob B. Taylor, the wife of our good Vice President and Business Manager.

I come now to Mrs. Thomas Sanders, whose husband also is being honored this evening.

Next may I present Mrs. Weidler, seated on Mrs. Sanders' right.

On her right is Mrs. Carman Blough, whose husband is being honored this evening.

On her right I come to Mrs. Hermann C. Miller.

On her right is Mrs. Samuel J. Broad, whose husband is being honored this evening.

On her right is Mrs. Clifford F. Hood, the wife of our speaker of the evening.

May I thank all of you ladies for being with us. Certainly you add a colorful and decorative note to this occasion.

Before coming to the introductions at the speakers' table, I should like to make one more statement to express our regret that Mr. Arthur B. Foye could not be with us this evening. He is the President of the American Institute of Accountants, and spoke on this afternoon's program.

Will you kindly reserve your applause until the introductions have been completed? On my right we have Mr. Merle Hostetler, Director of Research of the Federal Reserve Bank of Cleveland, who will speak on tomorrow's program.

Next we have Mr. John L. Carey, Executive Director of the American Institute of Accountants, and long time friend of these conferences.

I come next to Mr. Bland L. Stradley, Vice President of the Ohio State University, and in charge of student affairs. If there ever was a man well adapted to this position, it is Bland Stradley.

Next we have Mr. Mark E. Richardson, a partner in Lybrand, Ross Brothers and Montgomery in New York City, who will speak on tomorrow's program.

Next we have Mr. Forrest G. Ketner, a Trustee of this University.

Next is Mr. Clarence Snyder, one of our former graduates, and now controller of the John A. Roebling's Sons Corporation of Trenton, New Jersey. He was a speaker at this morning's session.

Next we have Mr. George W. Schwarz, President of the Controllers Institute of America, Inc. He is also Vice President and Treasurer of the Wyandotte Chemicals Corporation. He will preside at tomorrow morning's session.

I come next to another Trustee of this University, Senator James W. Huffman.

Next we have Mr. Frank Arnold, a partner in Arnold, Hawk and Cuthbertson, and President of the Ohio Society of Certified Public Accountants, who presided at this morning's session.

Next we have Professor C. B. Nickerson of the Graduate School of Harvard University, who will receive the certificate in behalf of Mr. Sanders in the Hall of Fame ceremony.

I come next to Mr. Jacob B. Taylor, Vice President and Business Manager of the University, formerly Chairman of the Accounting Department, in whose name we continue to take pride in the roster of our faculty in accounting.

I come next to Mr. Samuel J. Broad, senior partner of Peat, Marwick, Mitchell and Company, of New York, who is being honored this evening. You will hear more about him shortly.

Coming back to my left, the first gentleman, Mr. Carman G. Blough, Director of Research of the American Institute of Accountants, who is also being honored this evening.

On his left is Mr. George D. Bailey, chairman of the Board of Nominations of our Accounting Hall of Fame.

Next we have Professor Hiram T. Scovill of the University of Illinois, also being honored this evening.

Next is Mr. Carl E. Steeb, Secretary of the Board of Trustees of the Ohio State University, and long a faithful friend of these conferences.

On his left is Mr. Frank P. Smith, Director of the Bureau of Business Research at the University of Michigan, and President of the American Accounting Association. He presided at the afternoon's session.

Next is Mr. I. Wayne Keller, Controller of the Armstrong Cork Company of Lancaster, Pennsylvania, President of the National Association of Cost Accountants, and a speaker on this morning's program.

Next is Dean N. Paul Hudson of the Graduate School of the Ohio State University, and a distinguished biologist.

On his left is Mr. Jonathan Harris, Industrial Accounting Consultant of Cambridge, Massachusetts, a speaker on this afternoon's session.

Now I come to Jack Fullen, Secretary of the Ohio State University Association, one of our very own.

On his left is Mr. Jack S. Seidman, partner of Seidman and Seidman of New York City, and a speaker on tomorrow morning's session.

On his left is Mr. Arthur Gunnarson, Secretary of the National Association of Cost Accountants.

At the end of the table is our own Professor Hermann C. Miller, Chairman of our Accounting Department, and director of this conference.

I come now to the introduction of our principal speaker, Mr. Clifford F. Hood, President of the United States Steel Corporation. I know that all of you are more or less familiar with the size and rank of U. S. Steel operations. In order to satisfy a curiosity, and to get something a little more specific before me, I checked the last annual report of U. S. Steel and found some very interesting figures. In 1953 the production in terms of ingots and casting was 35.5 million tons; shipments of steel production, 25.1 million tons; property expenditures, $361.4 million; property expenditures authorized at the end of 1953, $327 million; stockholders, $286 million; average number of employees last year, 310,560; sales in excess of $3 billion.

Our speaker this evening, President of this vast industrial empire, was born on a farm, graduated from the University of Illinois with a degree in electrical engineering. After his graduation he joined the staff of a firm in Warren, Ohio as sales engineer and assistant cable salesman. Two years later he went to the American Steel and Wire Company, a U. S. Steel subsidiary.

Then came military service in World War I. In 1928, after a number of promotions, he became Superintendent of the South Works. On January 1, 1933 Mr. Hood was made manager of Operations for the

Wooster District. In 1935 he was transferred to Camden as Vice President. On January 1, 1937 he was elected President of the American Steel and Wire Company. In 1950 he became President of Carnegie Illinois. In 1953 Mr. Hood became President of U. S. Steel.

Mr. Hood's civic activities include the chairmanship of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland, Director of the Chamber of Commerce of Pittsburgh, a Trustee of McGhee.

He will speak to us this evening on "A Bigger Pie Has Bigger Pieces." Mr. Hood.

A BIGGER PIE HAS BIGGER PIECES

By

CLIFFORD F. HOOD
President of the United States Steel Corporation
New York, New York

Dean Weidler, distinguished guests of the Institute on Accounting, ladies and gentlemen, members of the student body:

As you can surmise from the Dean's introduction, I feel rather at home here in Ohio, having been born and reared in the neighboring State of Illinois. He referred to the degree from the University of Illinois, but prior to receiving that, I received a degree in agriculture by association.

I remember so well the rivalry between the great athletic teams of the Ohio State University and the University of Illinois. Both student bodies were quite a bit smaller in those days than they are now. But the rivalry, I think, was just as keen.

I also feel rather close to Ohio because it was at Warren, Ohio that I obtained my first work after graduating from the University of Illinois. Then in 1935 I returned to Cleveland, Ohio where I spent a number of happy years working in that location.

I appreciate the warm reception and the warm welcome which you have extended to me, and I have a treasured friendship of a number of Ohio State University staunch supporters.

A few days ago I ran across a description of accountants that was new to me.

"Accountants," it read, "are the only kind of mathematicians who do not become confused by figures when a dollar sign is placed in front of them."

It is true that accountants never — well, hardly ever — lose their sense of direction even in the thickest fiscal forest. But the description I gave you is hardly appropriate to my purposes tonight.

It is much too flippant to convey my deep appreciation of the important and expanding role accounting holds in United States Steel Corporation. It is a much too superficial reflection on my gratitude for the invitation to talk to you tonight. And it is a much too shallow reflection of my pleasure in commending Ohio State University — through President Bevis, Dean Weidler, and Professor Miller — for its sponsorship of this annual seminar. The Institute On Accounting has produced knowledge and viewpoints of much value to fiscal control in American industry and business.

Perhaps the best way for me to express appreciation and gratitude is to say to you, most sincerely, that we of U. S. Steel want to do all we can to help broaden the service of the accountant to the American economy. We want to help erase the last traces of the outdated notion that the accountant is merely the compiler of the statistical chronicle of business and industrial concerns.

In times past, the function of the accountant *was* pretty well confined to setting down that which had already happened, to recording financial history. Today, the accountant must take an integral, constructive part in shaping that history. His is the obligation to analyze, to interpret—and to foresee—conditions which affect the production of goods and services.

The accountant must be the constant watchman for ways to reduce costs and thus prices; for ways to maintain profit and thus insure a supply of job-creating, job-protecting capital; for ways to meet competition and thus safeguard the vitality of the enterprise he serves.

In short, the accountant can have a very important hand in preparing a bigger economic pie, with bigger deserved slices for customer, employee, and owner.

Faulty Recipes

The kitchen of the American economy is rather cluttered these days with cooks who have conflicting ideas about that pie.

Some of them believe that the economic pie has become about as big as it is going to get. Those with that pessimistic outlook seem frantic to re-cut and re-distribute the pieces of the existing pie. They overlook, or deliberately ignore, the fact that in many cases the triumvirate that must be served—customer, employee, and owner—are one and the same person. They are oblivious or pretend to be, of the fact that in all cases the employee is also a consumer, and so is the individual owner. They are blind to the fact that in many cases, the employee of private enterprise also owns shares in corporate America, either directly or through his stake in insurance and pension funds.

The chefs of this misguided school of economic cookery, who keep yammering for a re-division of the existing slices of the economic pie, want the same amount of purchasing power shifted around, as if that would somehow increase it. They want the same tax load re-arranged, as if that would somehow reduce it.

Then we have in the kitchen of the American economy a highly vocal set of cooks who want to whip up another batch of the porous, insubstantial meringue of inflation. That would require going deeper and deeper into debt for the ingredients, which to begin with, are artificial. It would create only the illusion of a larger pie, prepared from a recipe calling for dollars that are worth less when they are received than when the rate of earning them was set; dollars that are worth less when the return on them is paid than when they were invested to provide new tools and new jobs in industry; dollars that are worth less when they have to be spent than when they were set aside for personal emergency or for years of retirement. That is like changing the marks on a measuring cup to show two cupfuls when you still have only one.

Accountants, as I understand it, have some professional sanction for ignoring fluctuations in the value of the dollar as a symbol of accounting. I doubt that the managers of their household accounts—their wives—do any such ignoring. Fluctuations in the value of the dollar are felt too keenly in household budgets to be ignored, especially when all the fluctuating is on the adverse side.

Nourishment for the Economy

Many things have happened in the last thirty years which were unfortunately conceived, from the standpoint of their effect on the economy. I am, however, more concerned with the future than with the past, except as the past has revealed pitfalls to be avoided and lessons to be observed. While the viewpoint I express here tonight might be considered a Broadening-out Concept for the economy, my remarks should be regarded as suggesting a new and promising re-orientation of our thinking and action.

It is my deep personal conviction that we need, all of us in America, a concept of thinking, planning, and acting in terms of creating more wealth for everyone.

That is the concept of more sales and more production of high-quality goods, at lower unit cost through increased mechanical and human efficiency, so that more people can afford them, and more people can be employed in providing them. That is the only way I know to provide the nourishment that will increase our economic stature.

The Broadening-out Concept for the American economy—the concept of concentration on creating for the broad benefit of the many, not the narrow benefit of a few at the expense of others—is the concept of new products and new processes which can contribute to a longer, pleasanter, safer, and more healthful life for the American people.

It is the concept of regarding profit in its true perspective, and as a measure of the health of American private enterprise and, therefore, of its ability to serve everyone in an ever-broadening way.

That, in turn, means, among other things, undiminishing emphasis on research and technology. It means a continuing flow of investment capital, and of reinvested corporate income—all to pay for the tools needed for new products and more productive processes—for the benefit not of a few, but every one.

Bombast a la Mode

The Broadening-out Concept is the very antithesis of what some of the current spielers of economic bombast say is the recipe of American corporate management. Those who assert that present day corporate management is wedded to any kind of a process permitting only a very little ultimately to reach the many, are talking through their hats. And the hats have fallen down over their eyes and ears, so that they cannot see economic fact, cannot hear economic fact, and therefore, cannot speak economic fact.

The talkers-through-their-hats, the ones who say everything would be all right if we just re-divided the slices of existing wealth, keep trying to foist an unadulterated delusion on the American people. It is the delusion that money which a corporation obtains in the forms of increased sales or lowered taxes is shoveled into a vault, where it is counted and hoarded by the owners. The owners, as you know, are usually depicted as being a little coterie of "big boys" whose pockets are already bulging with currency and securities.

That is arrant nonsense! U. S. Steel's stockholders are certainly typical of the owners of corporate America today. The demagogue's picture of them is contrary to the fact revealed by a survey of U. S. Steel's shareholders. It is contrary to facts adduced from U. S. Steel's financial record.

There are more U. S. Steel stockholders with total incomes of around $4,500 a year or under, than with incomes greater than that. Shares representing close to 40 per cent of the individual ownership of United States Steel Corporation are held by persons with incomes of less than $5,000 a year. In many, if not a majority of cases, that is the joint income of both man and wife.

To me, that means that the owners of American corporate enterprise today are indistinguishable at the store counter, or in the automobile sales room, from other citizens of this republic. Behind lawn mowers in a Columbus suburb, or almost anywhere in America this spring, they are indistinguishable from their next-door neighbors.

Proof of the Pie

The proof of the pie, like that of the pudding, is in the eating. I want to present to you tonight a simple analysis of financial facts about U. S. Steel which offers, I believe, cogent evidence that a bigger pie offers vastly more to those who share it, than does a mere re-arrangement of the pieces. It supplies strong support, I believe, of my conviction that all of the able minds of this nation should be centered on creating more economic value—more means for more people to elevate their standard of living—rather than on division of the wealth.

I am going to use data from U. S. Steel because I am conversant with those data and because I know how solid they are.

U. S. Steel, which is organized to perform a service with the thought of making a profit, is only one of about 100 American companies producing iron and steel. It produces just a little over 30 per cent of the steel manufactured in this country. But what I have to say about my favorite company is equally true of many industrial and business concerns throughout American private enterprise.

Like any other going concern, U. S. Steel has to pay its bill for purchased goods and services. It has to transmit to the various levels of government that part of its receipts representing taxes for which the corporation serves as an agency of collection. And it has to earmark part of its sales receipts to cover the wear and exhaustion of physical equipment. What is left of U. S. Steel's sales receipts from its customers may be termed new economic value resulting from the manufacture of corporation's products, and from which there remains to be paid the cost of employment that has averaged 88 per cent of that new value over the last 30 years. This new value the corporation has to work with is, then, U. S. Steel's direct addition to the national wealth. This addition is exclusive of other economic value the corporation has added indirectly through its buying of goods and services from more than 50,000 suppliers, all but four or five thousand of them small businesses.

The new economic value U. S. Steel adds directly to the economy has three components or pieces. Even though you accountants may not think of these components in such a gustatory fashion, I shall regard them tonight as making up U. S. Steel's economic pie that is susceptible of discretionary slicing.

First, of course, come the employment costs—current wages paid to labor and deferred wages set aside by law and by employees' bidding or consent for their future financial protection.

The second is dividends. These, after all, are wages paid for the use of risk capital entrusted to us by some 280,000 individuals, as well as by charitable, educational, and financial institutions, whose funds must be prudently employed. Capital, like labor, is worthy of its hire.

The third component concerns money reinvested in the business to keep abreast of technological advancement and ahead of the competition in meeting the customers' requirements.

I am not unmindful that, for precise accounting purposes, a fourth component of new economic value might be included. That is interest on debt—the wages paid for money borrowed.

Payment of such an item, of course, cannot be arbitrarily diminished or neglected, any more than can payment by a home owner of the interest on his mortgage. In U. S. Steel's case, however, that item has become so small—only one-tenth of one per cent of the whole economic pie—that I excluded it from my calculations, for simplicity and because that in no way affects my case.

How the Pie was Divided

I made an examination of the way those components of the pie have been apportioned each year for the last thirty years. The facts revealed by that examination strike me as a significant lesson in economics.

Labor's slice—employment costs—averaged 88 per cent of all the pie representing new economic value created by U. S. Steel over the 30-year period.

The stockholders' portion averaged only 8½ per cent.

A slice averaging only 3½ per cent of the pie remained for reinvestment in the business, in order to keep it efficient and competitive for the protection of our employees and our shareholders alike.

In no year since 1930 has the slice representing U. S. Steel's employment costs been less than 80 per cent of the pie of new value we have contributed to the national wealth. And in eleven of those years it was above 90 per cent. This leaves only a mighty small sliver of the total pie for division into dividends and capital improvements.

In one sequence of years, labor was given the equivalent of the whole pie of new economic value created by U. S. Steel. The holders of common stock went without any return whatever for seven long, lean years, while reinvestment in the business was denied to the point that it decreased almost a quarter of a billion dollars.

In the Size, Not the Slicing

This process of drastically altering the usual, or average, apportionment of the pie may have appeared warranted in the light of conditions existing when that took place. But a mere re-division of wealth never has and never will lift the nation's economic level.

For in the years I refer to—when labor's portion percentagewise was the largest it ever reached before or since—that portion was pathetically small dollarwise. Those were years when the economy lay prostrate, and every time it tried to get up, it was slapped down and kicked in the ribs with the pointed toe of socialistically inspired measures. May the day never again come when we shall be confronted with public policies designed to keep private capitalism battered, bruised, and emaciated.

For contrast, take the four years just passed. Never before in the corporation's history have so many dollars gone into labor's share of the economic pie. In each of these last four years, labor's share in dollars was almost as great, or greater than, the aggregate amount in the previous year for employment costs, dividends and money set aside for reinvestment in the business.

The management of U. S. Steel certainly does not want to see the portions of the pie of new economic value going to our approximately 300,000 employees and to our 286,000 stockholders grow smaller. Neither does it wish to see either's slice get larger wholly at the expense of the other's, in a robbing-Peter-to-pay-Paul process.

Remember, I have been reporting fact as disclosed by my study of U. S. Steel's records. To say that I applaud the division of our economic pie, as that actually has taken place, would be to distort or place an improper construction on my theme that *it isn't the percentage of the pie that counts; it's how big the pie was to begin with!*

The size of the pie of new economic value created by U. S. Steel reached a low of around $70 million in one year during the nineteen thirties. It has not been less than approximately $1.4 billion in any of the last four years. In 1953, when the size of the pie was approximately $1.8 billion, the portion representing employment costs amounted to considerably more than $1.5 billion. And just to report a matter of financial fact, employment costs last year were just a fractional share under 88 per cent of the whole pie of new economic value, or right at the 30-year average; and the fluctuations in our employment figures have not affected this appreciably.

Isn't this clinching evidence that 80, 85 or 88 per cent of a big pie is much more satisfying, much more nourishing, to those who receive it and to the whole economy, than 100 per cent of a depression-size pie?

Bigger Pie—Bigger Pieces

I submit that it is futile to attempt to create prosperity by giving one segment of the economy an inordinately large part of the pie, at the expense of the others.

I reiterate that no government will ever create or sustain prosperity by applying policies that inhibit the incentives of private capitalism to elevate the living standard of the American people by creating a larger pie of economic values.

There are tell-tale signs here and there of efforts to review the myth that in the thirties, spending by government and starvation of private enterprise cured unemployment. The cold, inescapable fact of history— comparatively recent, but too-greatly forgotten history—shows that that *is* a myth and nothing more. As late as 1939, there were still about 9.5 million jobless out of a civilian labor force of 55 million.

Economic truth consigns to the incinerator every socialistic philosophy that has ever been tried. I have shown you that the new economic value created by U. S. Steel, as an organiaztion which I think you will agree is representative of our private capitalism, has gone to labor in ten times as generous a helping as it has gone to the 286,000 owners of the business. So let's not allow the vitality of our economy to be sapped by spending more strength of mind in quarreling over how to divide the national wealth, than in working in an intelligent, united way to create more of it.

A bigger pie DOES have bigger pieces. It is produced by the concentration of every able-minded person, regardless of his place in the economy, on more efficient production; by concentration on the development of new products, on capital's incentive to invest and on labor's incentive to work at tasks that are useful and needful to the end product. That is the Broadening-out Concept.

We must guard against honeyed theories that mere re-division of existing wealth can create an improved standard of living for the American people. We must never tolerate public policies that only provide more dollars of less value, or policies that choke off technological progress and impede productive efficiency. I thank you.

PRESENTATION OF DISTINGUISHED ACCOUNTANTS TO THE ACCOUNTING HALL OF FAME

DEAN WEIDLER: We come now to the Accounting Hall of Fame ceremonies. This is the fifth time that we have met to honor our outstanding accountants for their contributions to the profession of accounting by their election to the Accounting Hall of Fame. In all, 11 great accountants have been honored, and you will note that four great accountants are to be added to this distinguished list.

In this connection may I thank the members of the Board of Nominations for their services.

Vice President Jacob B. Taylor will now confer the honors, and George Bailey, chairman of the Board of Nominations, will present the candidates. Mr. Taylor and Mr. Bailey.

MR. BAILEY: It is my very great honor as chairman of the Board of Nominations to present four accountants for awards as members of this Hall of Fame of The Ohio State University.

First, the Board of Nominations of the Ohio State University Accounting Hall of Fame presents Carman George Blough.

Mr. Blough was born in Johnstown, Pennsylvania. He graduated from Manchester College in 1917, and received the degree of M.A. in 1922 from the University of Wisconsin. Later, he also studied at Columbia, Harvard and the University of Chicago. In 1944 he received the honorary degree of LL.D. from Manchester College. He has taught at various colleges and universities, including the University of Wisconsin, the University of North Dakota and the American University, and has never lost his interest in teaching. At present, he is Adjunct Professor of Accounting at Columbia University.

In 1922 he became a Certified Public Accountant in Wisconsin, and holds CPA certificates in other states. He was associated with Arthur Andersen and Company for a number of years and became a partner of this firm.

When the Securities and Exchange Commission was created in 1934, Mr. Blough was appointed Chief Accountant. He served in this capacity until June, 1938. At the outset, he stated as a policy that financial statements filed with the Commission should reflect generally accepted accounting principles and auditing procedures. This policy, rather than one of arbitrarily prescribing rules, brought about a close cooperation of the Commission with the appropriate committees of The American Institute of Accountants which has continued to the present time.

During the Second World War, he served with high distinction as Director of the Procurement Policy Division of the War Production Board and represented this Board on the Price Adjustment Boards of the War, Navy and Treasury Departments, Maritime Commission, Reconstruction Finance Corporation, and War Shipping Administration from 1942 to 1944. He was a member of the United States War Contracts Price Adjustment Board and consultant on renegotiation and contract termination for the War Production Board during 1944 and 1945. His paper at this Institute of Accounting in 1943 dealt with some of the problems of War Contract Renegotiation.

He was President of The American Accounting Association in 1944.

As a member of the American Institute of Accountants since 1929, he has been a member of a number of important committees, including the Committee on Accounting Procedure.

He has been Director of Research of the Institute since 1944. During this ten year period, many studies of major importance have been made under his guidance by members of his staff and by Committees of the Institute. In this capacity he has made a distinctive contribution not only to accounting literature, but to accounting practice. It was indeed fitting that the Institute in 1953 honored him with a distinguished service award.

In recognition of his constructive leadership in the fields of research and public service, the Board of nominations of The Ohio State University Accounting Hall of Fame is proud to present Carman George Blough.

MR. TAYLOR: Mr. Blough, for your outstanding contribution in the development of the profession of accounting, upon the recommendation of the Board of Nominations, by the authority of this University, I have the honor to inform you that your name has been placed in the Ohio State University Accounting Hall of Fame. In testimony thereof, I present you with this appropriate certificate, duly signed and with the seal of the University attached. To the felicitations of the University, I add my personal felicitations.

MR. BLOUGH: Thank you very much. Dean Weidler told me that it was appropriate for me to say something at this time. I find it very difficult to find anything appropriate to say, except to express my gratitude at having been selected to join this group of honored personnel in the Accounting profession.

I think it might be appropriate for me to mention the fact that it seems to me that membership in this Hall of Fame is evidence of something that ought to be very inspiring to many of the younger men. I find in looking over the list of the fourteen others who have been honored in this way, that I had the opportunity to be closely associated with ten of them.

That means that most of these men have been active professionally during my mature lifetime, and while I have grown gray in the profession, it has been a very short time in the life of a profession. And yet the selections for this Hall of Fame have gone back to the beginnings of accountancy in the United States.

This is truly a young profession, and there are opportunities for accomplishment which have been undreamed of until now.

Two weeks from now, it is to be my privilege to meet with a group of accountants who are going to study a brand new problem. It is, "What kind of auditing procedures are appropriate in the auditing of accounts kept on electronic calculators?" That is just the beginning of a new era. There is a challenge for all of us. Thank you very much.

MR. BAILEY: The Board of Nominations of the Ohio State University Hall of Fame presents Samuel John Broad.

Mr. Broad was born in England. Moving to Canada, he received his B.A. degree from Queens University in 1916.

He was employed by Peat, Marwick, Mitchell and Company in 1916, and has been a partner in this firm since 1927. Not only is he a Certified Public Accountant of New York and other states, but he is also a Chartered Accountant of Canada. He received the honorary degree of Fellow of the Chartered Accountants of Alberta in 1945.

Mr. Broad has been a director of the New York State Society of Certified Public Accountants, and has served on a number of its important committees.

As a member of the American Institute of Accountants since 1921, he has served as treasurer for several terms, as vice president, as a member of Council, as a member of the Executive Committee, as chairman of both the Committee on Auditing Procedure and the Committee on Accounting Procedure.

He has been a member of the Committee on Relations with the Securities and Exchange Commission, a member of the Editorial Advisory Board, and also a trustee of the Benevolent Fund. At present, he is chairman of the Committee on Accounting Personnel. In 1944 he was honored with the presidency of the Institute. In 1952 he was the recipient of the American Institute of Accountants distinguished service award.

Mr. Broad has served fifteen years as chairman or member of the Committee on Grievances appointed by the State of New York under the CPA law.

During the past twenty years, many new challenges have been presented to the profession of accounting. These have been caused chiefly by the violent changes in our economy. Mr. Broad has been a real leader in meeting these challenges through his writings and service on committees. In 1948 he read a paper at the Ohio State University Institute of Accounting entitled "Impact of Rising Prices on Accounting Procedures," which has been reprinted and widely quoted.

He was elected vice president of the American Accounting Association in 1950. Also, in 1950 he served as the first chairman of the Board of Nominations of the Ohio State University Hall of Fame.

For his many years of devoted service, both as an eminent practitioner and as a farsighted leader in professional organizations, the Board of Nominations of the Ohio State University Accounting Hall of Fame is proud to present Samuel John Broad.

MR. TAYLOR: Mr. Broad, for your many and impressive contributions to the development of the profession of accounting, upon the recommendation of the Board of Nominations, and under the authority of this University, I have the honor to inform you that your name has been placed in the Ohio State University Accounting Hall of Fame. In testimony thereof, I present you now with this certificate, duly signed and bearing the seal of the University. Sam, not only the University's felicitations, but mine for an old and valued professional friend.

MR. BROAD: Thank you, Jake. Thank you, George. Dean Weidler told me about the same as he told Carman Blough: "Say something or say nothing; you can talk as long as you want." But he did not say outright, "I hope you make it short."

Two or three years ago, I was wearing the shoes you are wearing tonight, George, and had the privilege of presenting the nominees to the Accounting Hall of Fame. I did not realize until tonight what a spot I was putting them in by expecting them to say a few words. And so, for one of the few times in my life, I am rendered speechless. I will just say: thank you very much.

MR. BAILEY: The Board of Nominations of the Ohio State University Accounting Hall of Fame presents the name of Thomas Henry Sanders.

Professor Sanders was born in England and graduated from the University of Birmingham in 1905. He was employed by the firm of

Rudge-Whitworth in Coventry from 1905 until 1910. He then went to Yamaguchi, Japan, where he taught commercial practices from 1911 to 1917. In recognition of his services in that country, he was decorated with the Order of the Rising Sun.

Upon returning to this country, he was a member of the faculty of the University of Minnesota for two years, from 1918 to 1920, when he joined the faculty of Harvard's Graduate School of Business Administration, where he served until 1952, and was then Emeritus Professor until his death in 1953.

Professor Sanders contributed many articles to professional journals. Also, in 1938 he collaborated with Professors Hatfield of the University of California and Moore of Yale University in writing the monograph "A Statement of Accounting Principles." In 1949 he published a study entitled "Company Annual Reports," and he was the author of "Effects of Taxation on Executives," published in 1951.

The National Association of Cost Accountants honored him with the presidency in 1931; the American Institute of Accountants retained him as a Director of Research from 1939 to 1941; he was a consultant on accounting with the Securities and Exchange Commission from 1934 to 1935; and he was Dickinson Lecturer for the academic year 1948-1949 at the Harvard Business School.

With the outbreak of World War II, he entered the field of public service as Chief of the War Production Board Cost Analysis Section, and as a member of the Price Adjustment Boards of the War and Navy Departments.

For his distinguished service in the fields of teaching, constructive writing and public service, the Board of Nominations of the Ohio State University Accounting Hall of Fame is proud to present Thomas Henry Sanders.

MR. TAYLOR: Professor Nickerson, since you stand in the place of Professor Sanders tonight, we will say to you what we should like to have said to him on this occasion. He, too, was an old and valued friend. I knew him throughout my entire accounting life. For his outstanding contributions to the profession, and they certainly were many, and upon the recommendation of the Board of Nominations, I have the honor to inform you that his name has been placed in the Ohio State University Accounting Hall of Fame. In testimony thereof, I hand you this certificate for Professor Sanders, duly signed and with the seal of the University attached. May I give you the felicitations which should have been his, sir.

PROFESSOR NICKERSON: Thank you, Mr. Taylor. I am most happy to receive this certificate in behalf of Thomas Henry Sanders. This is a great honor, not only to Professor Sanders but to our school, and to Harvard University. Our only regret, of course, is that he is not here in person to receive it.

Professor Sanders' outstanding professional accomplishments have been cited and I shall not dwell on them further. I should like to note, however, that in his many outside engagements his services were sought not alone for his professional knowledge and judgment but also because of his basic integrity. He was not only able but willing to see all sides of an issue. Because of his recognized fairmindedness and other personal qualities he was able, time and time again, to bring strong-minded men into agreement, whether on matters of principle or courses of action.

He was truly a great teacher of accounting. Indirectly and by example, he also taught high moral and ethical standards. While helping students to become good businessmen, he helped them to see that the successful man is also a good husband, a good father, and a good member of his community.

All who knew him, even briefly, were moved by his friendliness, his wit, and his gentle spirit. For his professional qualities he was greatly respected. For his human qualities he was greatly loved.

MR. BAILEY: The Board of Nominations of the Ohio State University Accounting Hall of Fame presents Hiram Thompson Scovill.

A graduate of the University of Illinois, he passed the Illinois examination for Certified Public Accountant in 1918. After a number of years in public accounting practice, he returned to the university to become head of the Department of Business Organization and Operation, in which capacity he served until his retirement in 1953. He served as Acting Dean of the College of Commerce for five years, from 1942 to 1947. In recognition of his years of service, both as a teacher and administrator, the Alumni of the College of Commerce in 1952 established a Testimonial Scholarship Fund in his name.

He was one of the early Presidents of the American Association of University Instructors in Accounting, which was the forerunner of the American Accounting Association. He was President of Beta Gamma Sigma, National Commerce Honorary Fraternity for six years, and President of Beta Alpha Psi, National Accounting Fraternity for five years. With all of these administrative and teaching responsibilities he is the author and co-author of a number of accounting texts which are in use in colleges and universities. He wrote numerous articles and book reviews in professional journals.

His interest in education has always been a broad one. He was a member of the American Council on Education's Special Committee to study Collegiate Business Education from 1937 to 1942, and President of the National Conference of State Universities' Schools of Business from 1944 to 1946. He is now a member of the Board of Education in his home city of Urbana, Illinois.

In the professional field he has served as President of the Illinois Society of Certified Public Accountants, as a member of the Board of Examiners of the American Institute of Accountants, and also as a member of the Committee on Accounting Procedure. In 1949 he was the recipient of an award by the American Institute of Accountants for "Outstanding Service to the Profession"—the first university professor to be so honored.

At the outset of his career, Professor Scovill envisaged accounting as a profession with increasing social and economic responsibilities. This he taught by precept and example. He has had an unwavering faith in education as a vital force in attaining this objective. The present high standards of service and professional conduct can, in a very large part, be attributed to the devotion to this ideal of such men as Professor Scovill.

In recognition of the many years of devoted service to the profession of accounting as an inspiring teacher and educational administrator, the Board of Nominations of the Ohio State University Accounting Hall of Fame is proud to present Hiram Thompson Scovill.

MR. TAYLOR: Professor Scovill, in recognizing you as a distinguished colleague and an old, old friend, dating back to the pre-Ohio State days when I was a predecessor of Mr. Carman Blough, for your outstanding contributions to the development of the profession of accounting, upon the recommendation of the Nominating Board, by the authority of this University, I have the great honor to inform you that your name has been placed in the Ohio State University Accounting Hall of Fame. In testimony thereof, I present you with this certificate, duly signed and bearing the seal of the University. Accept the University's felicitations, and mine.

MR. SCOVILL: Thank you, Jake, and all of you here. I thought we had an agreement before this session started, that we were not going to speak. There is not much that I shall say, but I suppose I have to keep in line.

If I were to make a speech, I should probably begin to talk about the lot some of us have played, and the good fortune we have experienced in being able to be in this field of endeavor in our time.

At the time I was attending the University of Illinois, I did not take engineering; I took the next best thing. That involved mathematics and economics, and just a very small amount of accounting. These led me into the accounting field. I am very glad I followed it, because as I glanced over the list of the past Presidents of the Institute, I felt proud that I knew all but three or four of them personally. I have been glad to associate with such men.

Not long ago as I had occasion to look at the list of past Presidents of the Illinois Society of CPA, which held its 50th anniversary session a year ago, I was surprised and pleased to see that I knew all of them personally. That makes me pretty old, to know 50 past Presidents of the Society whose term of office is one year each. But it shows that one can be fortunate enough to be in the right place at the right time in a growing profession. I have been glad of the opportunity to help these and many other capable accountants mold opinion, over the years on accounting theory and procedure. I hope those who follow us will have as much pleasure as I have obtained while teaching, thinking and writing for many years in the field .

DEAN WEIDLER: Thank you, Mr. Bailey and Professor Taylor. And now ladies and gentlemen, we stand adjourned.

FIFTH SESSION

FRIDAY, MAY 21, 1954—10:00 A.M.
The Ohio Union — West Ballroom

Presiding:

GEORGE W. SCHWARZ, *President, Controllers Institute of America, Inc.; Vice President and Treasurer, Wyandotte Chemicals Corporation, Wyandotte, Michigan*

Paper: "Federal Tax Planning"

MARK E. RICHARDSON, *Partner, Lybrand, Ross Bros. & Montgomery, New York, N. Y.*

Paper: "Current Developments in Income Taxes"

J. S. SEIDMAN, *Partner, Seidman & Seidman, New York, N. Y.*

FIFTH SESSION

Introductory Remarks

Chairman George W. Schwarz: Ladies and gentlemen, the fifth session of this Institute on Accounting will please come to order.

When I assumed the role of President of the Controllers Institute of America, the platform on which I dedicated my year of service was brevity. I promise that since this is the second day of the Institute, there seems to be little reason to indulge in preliminaries.

I should, however, delay long enough to express my sincere thanks to Hermann Miller for inviting me to attend your meeting, and to participate as presiding officer today. I am indeed gratified for this opportunity to be with you. As a Michigander by choice, I have a much greater feeling of security on this day in the spring than I might have were the annual football battle the occasion for my being here.

I see in this morning's paper that the Ohio State University is in second place in NCAA baseball League and Michigan is fourth, and both are playing today. I wish both of them luck!

Our session begins with an address on "Federal Tax Planning" by Mr. Mark E. Richardson, who is one of the outstanding people in accounting today. He has long been recognized as an author and lecturer on tax matters, being co-author of "Montgomery's Federal Taxes—Corporations and Partnerships", and having spoken at more than a dozen tax institutes in recent years. The paper he presented at the 1951 Eastern Spring Conference of the Controllers Institute was one of the high spots of that gathering.

Mr. Richardson is a partner in the firm of Lybrand, Ross Brothers and Montgomery. He has been affiliated with that firm since 1922, and was, for a time, the resident partner in charge of its Washington office. He has served on several advisory committees to governmental agencies, including the Advisory Group on Internal Revenue Service Reorganization, a Congressional Joint Committee on Internal Revenue Taxation. Mr. Richardson is co-chairman of the National Conference of Lawyers and Certified Public Accountants.

A former vice president of the American Institute of Accountants, Mr. Richardson now heads its Committee on Relations with the Bar, and is a member of its Nominations Committee. He has served on its Council and has been chairman of its Committee on Federal Taxation.

He received a distinguished service award from the Institute in 1953. He is a former director of the Philadelphia Chapter of the National Association of Cost Accountants, and is active in the American Accounting Association and the National Tax Association.

Greetings, Mr. Richardson, we are happy to have you as the first speaker of this session.

FEDERAL TAX PLANNING

By
MARK E. RICHARDSON,
Partner, Lybrand, Ross Bros. & Montgomery
New York, N. Y.

It is possible to construe the intent of the title of this paper as relating to fiscal planning by the federal government. However, such an interpretation would mean a lengthly excursion into economics and politics; and such a subject-research does not seem appropriate for this occasion. It is presumed, therefore, that a more appropriate approach is that based upon possible planning by the taxpaying public.

Planning, with regard to federal taxes, must involve at least three points of determination. First would be such planning as relates to the basic federal tax system and the level of rates presently in effect. Second would be such planning as must have regard to technical changes presently taking place. The third determination would be such tax planning as would seem appropriate no matter what technical changes might be enacted, and this is the type of planning to which most businessmen and their advisers are continuously committed.

While little change has taken place in our basic federal tax system since the enactment of the Sixteenth Amendment, a great deal of study has been made of that system; and any proper planning must be done with an understanding of the results of such studies and a clear picture of the prospects for change.

Somewhat similarly, careful planning must give consideration to the prospects within our systems of major rate changes, as any major change in rate would be as important as a basic change in system.

An understanding, at least to a limited degree, of the present federal fiscal position is an essential requirement in consideration of the prospects for the kind of changes first under discussion. This gives rise to an inquiry as to the best source of understandable and reliable data on our fiscal position. To a group of accountants, the obvious answer is the one which would develop in business; and that would be a review of the financial statements and a study of the accounting system supporting such statements. Unfortunately, in the instance of our federal government, the apparently simple approach is not possible. The federal accounting system (and the term is used rather loosely), does not readily lend itself to financial interpretation. Such statements as are published are generally hybrid combinations of cash receipts and disbursements, appropriations (but not complete appropriation accounting), budgets, and to some extent, fund accounting.

Probably the best available source of appropriate data is the reports published monthly, and summarized quarterly, by the Council of Economic Advisers. The reports of this Council, being based upon information obtained from many sources and representing the basis of economic advice presented to the President, seem more complete and more understandable than most other available data. It is to this source (the last available report of the Council of Economic Advisers), that we turn for the information upon which to evaluate the prospects of basic change in our tax system and to do our planning in accord therewith.

Such last report indicates a cash budget for the federal government at a current rate of approximately $74 billion. Planned economics may reduce this rate of cash expenditure to approximately $71 billion by the end of the next federal fiscal year. Based upon a budget at the reduced amount, there is an anticipated cash deficit for the current fiscal year of between $4 to $5 billion.

For present purposes, these figures of rate expenditure have significance only as they can be related to national income and possible tax revenues. In this regard, let us again turn to the last report of the Council of Economic Advisers. Here we find that the best determination of the rate of national income at the present time indicates a rate of approximately $307 billion. Simple arithmetic then shows us that the current rate of federal expenditure closely approximates 25 per cent of the total rate of national income, which is a ratio which many economists for years have indicated is a maximum without disastrous results to the economy.

Based solely on the rate of expenditure previously discussed and the fact that, because of political pressure, sincere efforts have been made to pare such budget to a reasonable minimum, it seems apparent that, still operating at a substantial deficit, we cannot anticipate any material reduction in the "tax take" in the aggregate. To do our planning properly, however, we must investigate the possibility of a shift in the tax burden between classes of taxpayers, either as to form (corporation aganst individual), or as to size. Let us first study the corporate situation. It might be important in this regard to determine the number of corporations which bear the major proportion of the corporate tax burden.

The last available data, that for the year 1950, indicates that approximately 660,000 corporate returns were filed. Such a figure indicates an extensive field for change and possible increase of the corporate tax burden. However, of this number, 36,000 represented inactive corporations; approximately 200,000 were corporations with a deficit from operations; and 328,000 were corporations with less than $25,000 of taxable income. Thus, of the total of 660,000 corporate returns, only 96,000 had incomes in excess of $25,000. The available source of additional revenue of this nature is not nearly so large, therefore, as might first appear.

Of even more importance as we plan the possibility of tax change, is a study of the total income of corporations before and after taxes over a period sufficiently long to give us dependable data. A very condensed tabulation for this purpose is as follows:

Year	*Income Before Taxes*	*Income After Taxes*
1946	$23.5 billions	$13.9 billions
1951	43.7 billions	20.1 billions
1952	39.2 billions	18.6 billions
1953 (Estimated)	43.2 billions	19.6 billions

It is readily ascertainable from this tabulation that an apparent ceiling of corporate income after taxes has been reached which no longer provides a substantial margin for expansion and which does not allow any heavier burden of corporate taxation without affecting the incentive of corporate management.

For comparison with the foregoing statistical data and as further information in our scheduled planning, let us look at the amounts of federal expenditures for a somewhat similar period of years:

Year	*Total*	*Nat'l Security Portion*	*Other*
1948	$33.7 billions	$11.7 billions	$21.4 billions
1952	65.4 billions	43.8 billions	21.6 billions
1953 (Estimated)	74.3 billions	50.3 billions	24.0 billions

Again, the "constant" nature of the expenditures for other than national security indicates the need of maintaining revenues until the national security expenditures can be reduced.

It seems reasonable to judge from the foregoing that our corporate income structure is such that we cannot shift any greater proportion of our tax burden to that source, and the nature of our federal expenditures is such that we cannot anticipate any substantial reductions in corporate taxation.

Our next step is a study of the situation as it relates to individual incomes and the prospects of material change in either kind or rate of tax as applied thereto.

It seems unnecessary to resort to economic data or published statistics to support a statement that the level of individual income taxation is already so high as to be burdensome; in fact, so high as to affect individual initiative at times. An initial rate approximating 20 per cent, after exemptions which have no regard to reality, is a sufficient indication in itself of the burdensomeness of our present individual tax structure.

However, this does not remove from consideration the possibility, so often proposed by agitators and unsound politicians, that we could shift a great portion of our individual taxation to the wealthy. It takes only a brief look at the facts to dispel any disillusionment on this score. If the federal government were to confiscate *all* incomes in excess of $100,000 a year instead of applying the present high rate of tax, the additional revenues so obtained would match the rates of federal expenditure for about one day. It might well be said that when someone speaks of a wealthy person, he is not speaking of $100,000 a year but of $10,000 a year. Latest available statistics indicates that if the federal government confiscated all incomes in excess of $10,000 a year, it would obtain sufficient revenues thereby to operate for about one month. Shifting of the tax burden to the wealthy to any greater extent than is presently done would not seem to accomplish much for us and should not be seriously considered in our planning for possible tax changes.

The picture previously painted is not a very optimistic one and rather clearly eliminates any prospects for changes in rates under our present basic system. Is there, then, any chance that this basic system might be changed within the foreseeable future?

Numerous proposals have been made in recent years that our systems of taxing income be so reconstructed that it would impose a tax upon kinds of income, that is, income from business operations, income from compensation, income from investments, etc., rather than upon classes of recipients as at present. Admittedly, it seems unsound to tax the same income if earned by a corporation in an entirely different manner than if it is earned by an individual; or to tax it in an entirely different manner if earned by a trust or an estate. Despite the equity of such proposals, it seems unlikely that change in this direction can find its way into the revenue system which has now become so well established.

There is one basic change, however, which has been proposed many times over the years and which recently has received further consideration. This is a change from a major dependence upon taxation of income to a lesser dependence in this field, and a shift of at least a portion of the tax burden to a general sales, excise, or spending tax.

Students of taxation and of economics have studied many times such a proposal with varying conclusions. One tax study which went extensively into a consideration of this subject was entitled "A Tax Program for a Solvent America," issued by the Committee on Postwar Tax Policy in 1945. This was a research study by responsible people (each member of the Committee being an accepted tax authority), and the Committee headed by Roswell Magill. Reference is made to this study because it indicated that even in 1945 our federal government was depending entirely too much on a system of income taxation. The study also indicated that any such system, in order to be even reasonably productive, would always have to start with a heavy tax rate on the lowest income brackets.

It might be of interest to know the basis of the suggested Tax Program for a Solvent America. The considerations of the Committee and its proposals were somewhat summarized in a chapter entitled "Estimated Revenue Needs of Proposed System." This chapter indicated estimated national incomes at varying levels of $115 billion, $125 billion and $140 billion. Comparable budget estimates were $15 billion, $18 billion and $22 billion. These figures are currently of interest for two reasons. One is the fact that the Committee, as learned and responsible as it was, had no concept of an economy which would produce the present national income previously referred to of approximately $300 billion. Of even greater significance possibly is the fact that the Committee did consider a national budget approximating $22 billion, which is just about where we are in our other than national security expenditures.

As previously stated, even without concept of the present economic levels, the study clearly indicated the need of further consideration of a shift to a broad excise or similar tax.

Just a short time after the release of the study referred to, Professor Harold Groves published, in 1946, under the auspices of the Committee for Economic Development, a study entitled "Postwar Taxation and Economic Progress." This study, while obviously not suggesting a sales or spendings tax and while seeming to deplore the possible need thereof, recognized such need and emphasized the precarious position of too much dependance on direct taxation of income.

To summarize all of the foregoing as to considerations involved in planning for a change in basic system or rates, the conclusion is justified that material increases or decreases in either corporate or individual income taxation cannot be expected; that any shift in the base of income taxation does not seem possible either between kinds of taxpayers or by size; and that the only possible change, seemingly remote, might be a shift to a general excise or sales type of tax.

Obviously, tax planning at the present time must seriously concern itself with the technical changes currently taking place. Such changes are made the basis of another paper being presented at this meeting and therefore, will not be discussed here. However, it is important to keep in mind that certain suggestions or proposals which may be set forth in the balance of this paper should be considered in the light of the current changes.

Whether or not changes in the basic tax structure should take place or changes in rates become effective, and irrespective of such technical changes as might currently be enacted, there is a type of tax planning which must go on continuously and which is an essential part of management planning at all times. This third class of tax planning might, in itself, be divided into three parts, these parts being: (1) the use of the proper accounting methods or fiscal periods; (2) control over the time and amount of income; and (3) control over the time and amount of deductions. While these subparts of our tax planning are important within themselves for any particular taxable year, they become of even greater importance in those instances where loss carry-overs or loss carry-backs are involved.

Before going into any detailed discussion of each of the mentioned subparts of our planning, a little time for a discussion of the place in normal tax operations and tax planning of the so-called "check list" is needed. The tax check list idea is neither new nor novel and has been advocated by speakers and writers on tax planning for many years. In fact, so much publicity has been given to the idea that many people are inclined to discount its effectiveness. Unquestionably, the annual or periodic review of a check list of tax savings or tax planning ideas becomes monotonous and sometimes seems fruitless. However, when such a list is comprehensively prepared to start with, it serves a two-fold beneficial purpose. Not only does it regularly bring before the tax planners ideas which might have been forgotten, but it also fosters thinking about different tax treatments when methods of operations or production have changed within a company.

There is nothing novel about a company changing its way of allowing discounts; providing credit to customers; handling inventories; purchasing from different sources of supply; or any one of many other possible changes. Regularly, however, tax planners for the company may overlook the fact that any such change in business operation may have a tax effect which will be overlooked unless repeated reference to a check list is a customary practice. As is indicated, any such list to be used regularly by management or tax advisers should not only include such items as apply to the particular taxpayers when the list is prepared, but also such items as might conceivably apply should there be a change in method of operation.

For many years, the Internal Revenue Code has provided for the use of certain generally accepted accounting methods; and by statute or by regulations there have also been allowed several special methods applicable to particular industries or particular business practices. Examples of these are the installment method of accounting in appropriate instances; the completed contract method for general contractors; the farm and livestock methods for farmers or cattle raisers; and, of a more specialized nature, the LIFO inventory method. In actual practice, hybrid systems of accounting often have been accepted, and even some very specialized systems, as for example, the completed voyage method for ship operators, have been accepted although not specifically authorized in the regulations.

H. R. 8300 (the Internal Revenue Code of 1954), enacts into statutory language many of the administrative practices previously allowed. Such statutory recognition makes more important than ever the need for a proper understanding of the use of the various methods, when appropriate, as a part of sound tax planning. It is possible many times to make material tax savings by properly planning a change in accounting method or methods before entering into a new type of business enterprise or making a change in business operations.

Should we ever have an economic situation where business income remained reasonably constant, and a tax situation where tax rates also remained constant, there would probably be no particular benefit in planning as to the time of the receipt of income or the making of expenditures. However, such a condition of "status quo" has not existed and presumably will not exist. Many of the steps or procedures which might recommend themselves to business management as a means of avoiding violent fluctuations in income also seem appropriate as a matter of tax planning.

Little purpose would be served in discussing normal run-of-mine items which can be controlled to some degree in tax planning, and it may be sufficient to highlight some solely as examples or indications.

A simple control feature which often is overlooked is the possible use of consignment sales or shipment on approval rather than a normal sales procedure. A complete change of selling methods is not necessary in order to take advantage of the opportunities in this field, as portions of merchandise or classes of products can be sold in varying manners.

Many business managements dealing in heavy goods have been concerned with business advisability of leasing their product under maintenance contracts, rather than selling outright.

All too often the varying tax effects of the different methods of doing business are overlooked, or having once been considered, are never again referred to as possible planning for tax saving at a later date.

In varying limited circumstances, such as during consolidated return periods or at the time of an anticipated operating loss, tax planning should concern itself with the timing of intercorporate dividends. The fact that a benefit from a dividend received credit may be either lost or materially reduced during an operating loss year is frequently overlooked. In the contrary vein, the opportunity to make extensive intercorporate distributions often is overlooked in a consolidated return year.

There is nothing unusual in business life about the settlement of damage claims, patent litigation, etc.; but so often the parties to such litigation become so concerned with the merits of their case as to overlook the opportunities for tax planning or tax saving which arise from the time of settlement of such litigation. This is true even of tax litigation itself. In view of the present situation that income of this nature is not taxable until the right thereto can be reasonably ascertained and that deductions therefor cannot be taken so long as the amounts are in controversy, time of settlement is vital tax planning.

Despite a generally accepted accounting concept that a corporation dealing in its own shares is engaged in a capital transaction, the tax authorities, supported by most courts, have developed materially different tax treatments between the selling of Treasury stock and the selling of newly issued shares. Tax planning indicates, therefore, that transactions of this nature should never be entered into without a consideration of the varying tax effects.

With regard to tax planning through control over expenditures, it seems unnecessary to refer at any length to the normal control always available by decision as to time for major repairs, extensive advertising campaigns, etc. As previously discussed, one of the major control features in the field of available deductions is that relating to time of settlement of contested liabilities.

Because of the extensive study and research which must be entered into before acceptance and establishment of a pension plan, most companies, once having established such a plan, are prone to ignore it in future tax planning. This lack of consideration is likely to become serious when a drop in the business economy may make the provisions of the plan somewhat onerous. It should not be overlooked that many such plans lend themselves to amendment or to supplementation through profit-sharing arrangements. Planning of this type often will allow a reduction in current contributions without impeding the opportunity for an increase at a later date should such seem warranted.

As stated previously, all planning for control over the time and amount of both income and deductions becomes more important during a year in which it is anticipated that a loss from operations will result, or during a year to which an operating carry-back or carry-over is being applied. Because of the adjustments and limitations necessary under these circumstances, many unfair tax results obtain unless proper tax planning takes place.

CHAIRMAN SCHWARZ: We thank you, Mr. Richardson, for a very profound and thought-provoking discussion. I am certain that, even though you are so modest, many of us will get much from your talk.

A sketch of our second speaker appearing in Volume Eight of "Who's Who in Commerce and Industry" evidences his activities in many fields. His accomplishments are many and varied, and I cannot do justice to him in a brief introduction.

Both in New York and nationally, the name of J. S. Seidman carries important weight in accounting and tax matters. Tax columnist for the New York *Herald Tribune*, he wrote "Seidman's Legislative History of Federal Income Tax Law," and "Seidman's Legislative History of Excess Profits Tax Law."

As you have noted from your program, Mr. Seidman is partner in the accounting firm of Seidman and Seidman. It does not tell you that he is president-elect of the New York State Society of Certified Public Accountants, or that he is chairman of the Committee on Federal Taxation of the American Institute of Accountants, on whose Council he serves. He is also a member of the Advisory Committee to the Commissioner of Internal Revenue.

He will address us on "Current Developments in Income Taxes." I am pleased to present him to you now. Mr. Jack S. Seidman.

CURRENT DEVELOPMENTS IN INCOME TAXES

By
J. S. SEIDMAN
Partner, Seidman & Seidman,
New York, N. Y.

There is a bill wending its way through Congress right now. It is entitled "An Act to Revise the Income Tax of the Internal Revenue Laws." More accurately, it should be called an act permanently to relieve unemployment among accountants and lawyers.

It is a cute little monster. In standard bill print pages, it would cover 2,500 pages, but by a specially compressed edition, it is reduced to only 875 pages. One of the nice things about it is that all of us now are income tax experts, because we all have the opportunity to start from scratch. All past accumulated knowledge on taxes can be considered as automatically repealed.

Obviously, in this session we cannot do very much about coming to grips with the real inner vitals of a bill of this sort. What I propose to do is to review the high spots of some of the provisions, which we are likely to run into in accounting practice. In other words, we will confine ourselves more to the business phases and forget such personal things as exemptions and credits. Even then, the best I can do is to outline some of the basic principles that are involved. You can go on the assured assumption that any principle that I outline will, in fact, be subject to all sorts of ifs, buts, and exceptions.

Bear in mind that we are talking about something that is merely a bill. Unfortunately, this session has been staged probably six weeks too early, and so a lot of guesswork will be involved.

The bill, in its present status, has passed the House and is before the Senate Finance Committee. I am going to give you what I anticipate will be the Senate Finance Committee approach to the bill. I emphasize the Finance Committee approach because you can go on the assumption that in the area we are talking about, it will be the Finance Committee version which will ultimately become the law.

This bill will bring about a closer convergence between good accounting and tax accounting. In financial accounting, for example, if a company collects five years' rent in advance, you do not pick it all up as income. You apportion the collection over the five year period that is involved. That has not been the tax law up to now. On a tax basis, the company, regardless of whether it was on a cash or accrual basis, had to report the entire amount of rent collected in the year of collection. This bill will get back to good accounting by making it possible to defer the advance collections and spread them over the period that is involved.

One important restriction is made: You cannot spread it beyond five years after the year of collection. Another important restriction is that the new arrangement will apply only to taxpayers on the accrual basis; it will not apply to taxpayers on a cash basis. So much for the income side.

Now let us consider the deduction side. Up to now, the only type of reserves that it has been possible to deduct has been the reserve for depreciation, and the reserve for bad debts. Under the bill, the floodgates are being opened wide. You will be able to deduct for almost all the things that in good accounting you would be providing for by way of reserve. For example, it will now be possible to deduct reserves for cash discounts, reserves for vacation pay, reserves for product guarantees, reserves for freight allowances—the types of things which, in order to determine business income, you would have to take into consideration, even in advance of the precipitation of the actual event.

On the other hand, there is a limit to the distance you can go. There will be no permission to deduct reserves for general contingencies or for claims that are in litigation.

The impact this is going to have in the year of transition is intriguing. Let us suppose that the year of transition is 1954. A company for 1954 will be able to deduct not only its actual discounts sustained to 1954, but also the reserve for discounts which are apt to come through in 1955, applicable to 1954 sales. There will be a bunching of deductions in the one year of the actual expenses, plus the reserve.

Let us consider depreciation. The one outstanding new thing in the bill on depreciation is that it will give statutory sanction to a method of depreciation that is known as the declining balance method. Under the declining balance method, you take twice the ordinary straight line depreciation rate, and apply it to the cost of assets; you reduce the cost of the assets by that amount, and apply that same rate for the following year to the remaining cost of assets.

There are a couple of "buts" involved. To begin with, it will apply only to items that are acquired after the December 31, 1953, date. If the acquisition is by way of construction of property, it will apply only to the part that has been constructed or reconstructed after December 31,

1953. If the depreciable assets are bought by the taxpayer, it will apply only to purchases after December 31, 1953, and then only if it is *new* property, and the taxpayer is the first and original user of that property.

The declining balance approach to depreciation has been hailed as quite a liberalizing factor, almost as if it were a boon to business. Actually, no matter which way you cut it, you cannot take more than 100 per cent depreciation on the assets over their life. For every step up you get in the early part of their life, you must experience a step down later. Furthermore, if the period we are now going through becomes the test period for normalcy of later excess profits taxes, increased depreciation now can turn out to be a disadvantage rather than a benefit. Let us take the item of research expenses. What the statute is at the present time is a little unclear, because nothing has been said about them in the law in the past. That lack of clarity will be overcome by an affirmative revision which says that a taxpayer will be able to deduct research expenses as incurred, or if he wants to, he can defer and write off those research expenses over a five-year period. The profitable company is likely to want to deduct it immediately. A new company that faces losses is likely to want to defer the expenses. It can have its pick.

At the present time, organization expense can only be deducted in the year in which the company winds up its affairs. Under the bill, organization expenses can be written off immediately over a five-year spread. The bill, for some strange reason, applies only to organization expenses. It does not apply to reorganization expenses. Why there should be a difference between winding up a company and organizing a new one, as against changing the structure of the original company, is not too clear to me.

On executive compensation, our great national pastime is how to convert compensation into capital gains. One of the "rinkydinks" the present law has worked out is a thing known as restricted stock option. The only trouble with that arrangement in the present law is that an insider has not been able to take advantage of it, because the law restricted the use of stock options only to those who have less than a 10 per cent stock interest in the company.

Under this bill, an insider can get one of these stock options on two conditions. First, the option price has to be 10 per cent higher than the prevailing market price for the stock at the time. Second, the option must be limited in duration to five years after the option is granted.

Let us see what is going to happen with net losses. Under the present law, there is the right to carry back one year and go forward five years with net losses. The bill enables you to go back two years, and then go forward five years. We are making progress by going backwards one extra year!

Traffic in net loss companies is another intriguing thing. In order to curb the traffic, this bill says that if a company goes through a change of ownership of more than 50 per cent within a two-year period, then any of the past net losses of the company will be amputated, and there will be no carry forward.

Like all such things, when you close up one loophole, you generally open up a few others. The bill merely restricts the right to carry forward past losses of the loss company. They have not come around to the idea yet that there may be some valuable current losses in the year of the transaction that can be used and carried forward. They have not touched at all the problem that exists of putting profitable operation into a loss company. So I think we will still have some fun and a battle of wits with the Treasury people, or at least the statutory draftsmen.

On the other hand, there is a sad tale to report insofar as fiscal years are concerned. We accountants have been beating the tomtoms, trying to convince our clients as to the desirability of getting on a natural business year. By and large, I think we have done a pretty good selling job. Now, taxpayers on a fiscal year may lose out in many respects.

Several things that we have been talking about will not apply to a fiscal year company until the next fiscal year starts, rather than the January 1, 1954, date the calendar year companies start to benefit. These are the right of taxpayers to take all of their expense reserves; the right to deduct research expenses; and the right to deduct organization expenses.

A partnership has always had the right to start anew, and figure any fiscal year it wanted. A new partnership will now be able to fix any fiscal year it wants, but the price for doing so will be that the principal partners will then have to adopt the fiscal year in their own personal returns. Of course, if you have to do that, it will be a death knell to fiscal years.

On the other hand, there will be a favorable development on the status of treasury stock. Up to now, a company that bought and sold its own stock pretty much walked into a tax trap. The bill will eliminate all gain or loss on dealings in the company's own stock.

To those of you who are more sophisticated about tax matters, I am going to refer to what was known in the House Bill as subchapter C. The first thing I want to report to you is that whatever expenditure of midnight oil you may have invested in the study of the House Bill, you can now take as a deduction on your income tax return, because it is all a waste. Subchapter C has, for all practical purposes, been annihilated because there is a complete revision going to be made of it. I will just touch on a few changes.

The biggest bugaboo that the House tried to come to grips with is the process whereby ordinary income in the form of dividends is converted into capital gain. The process is known as a bail-out, and generally takes this form: A company has a lot of money. If it paid this out in dividends to the stockholders, they would have to pay whopping taxes. Instead, it declares a preferred stock dividend.

Now, the stock owner has a preferred stock. He can sell the preferred stock and cash in, and the sale results in a capital gain. Or he can sell the preferred stock back to the company and get the cash out of the company as a capital gain redemption. (Obviously, I am oversimplifying the transaction.)

What the House did was to impose an excise tax of 85 per cent on the corporation redeeming its stock. Now they are attacking the problem in a frontal way, where it should be attacked, namely: to hold that in the type of situation that I have just illustrated, that is, sale or redemption of a preferred stock dividend, ordinary income will result.

There will be several exceptions: one, if in connection with the redemption or sale, the stockholder gives up his entire interest in the company; second, if the company itself winds up, or a distribution annually, which additional note gives rise to this tax. The type of stock that I am referring to is going to get a number label. It will be referred to as Section 306 Stock.

Let us see what the bill is going to do with reorganizations. Under the House version, there was no such animal called reorganization. The Senate Finance Committee Bill will restore all of the definitions of reorganization to which we have pretty much become accustomed.

There will be two deviations. One, on a swap of bonds for bonds. Under the law as it now stands, if the swap is a taxable transaction, the tax is based upon the difference between the value of the new bonds you get, compared with the cost of the old bonds you relinquish. If it was nontaxable, then the new bonds would have the cost of the old bonds.

Under the new bill, there will first be a matching of the face amount of bonds in a swap. In other words, if you have $100 in bonds, and you swap them for $120 in bonds, then no matter what the $100 of bonds cost you, the $100 of new bonds will be deemed to take the place of the

$100 old bonds, and the gain will be based only on the value of the excess amount of new bonds, namely: the value of the additional $20 of bonds.

Then the other important exception to what we are accustomed to now will be this: Today, if a company owns stock in a subsidiary and it distributes that stock to its stockholders as a dividend, that dividend is taxable just like any other dividend. Under the bill, it will be possible to distribute the stock in a subsidiary tax free. Of course, again, there are some "buts."

The subsidiary and parent must be active companies for five years, conducting an honest-to-goodness business. They have been warned by the American Institute of Accountants that this will make possible some very interesting things. There will be nothing to prevent the parent company from transferring a lot of cash to the subsidiary. Instead of paying that cash out as a dividend, the parent distributes the stock of the subsidiary to its stockholders. That is tax-free and stockholders are free to go out and sell that stock of the subsidiary and, in effect, cash in on the subsidiary's cash, and do it by a capital gain route. There are no restrictions whatsoever to make it necessary for the stock of the subsidiary to be held for any length of time.

Another interesting thing will be the rules on liquidations. For those of you who like the numbers racket, 112(b) (6) and 112(b) (7) will make a comeback. It will be possible to wind up a company and eliminate the tax to the stockholders on appreciation of a company's assets.

But there are some new things this bill is going to do. If a company winds up, and it completes its wind-up within one year, then the sale of its assets by the company will be tax exempt to the company. In other words, a company will not be taxed for the profit on the liquidation of assets. That, of course, gets around double taxation in a realistic way.

Another thing that will be done is that if a company acquires controlling stock interest of another, and within two years after that acquisition winds up the subsidiary, then the parent company will be able to figure the cost to it of the subsidiary assets, the cost to the parent company of the stock in the subsidiary. For those of you who are up on their taxes, all that means is that there will be put in the statute the principles of the Kimball Diamond Case.

We might consider another corporate problem, old Section 102, now Section 531. It puts a penalty tax on a corporation that manipulates its dividend policy and holds back on the payment of dividends in order to save taxes for the stockholders. Congress is going to water-down this provision considerably.

To begin with, instead of the penalty being applied on the full amount of undistributed earnings of any year, it will be applied only to that portion of the undistributed earnings that is unreasonably accumulated. There is also going to be an accumulated earnings credit of $60,000. But more important than all that, if the company files a statement of the reasons for holding onto its profits, then the government, rather than the taxpayer, will have the burden of proving in the Tax Court that the corporation should be smacked down with the penalty. That is no light burden.

I want to touch on partnerships. One of the reasons that we do not have to dwell too long on the partnership provisions is that most of them will not become effective until 1955. In the first place, the partnership will now be treated as an entity and apart from the partners. The partnership will almost be looked upon as a corporation. Dealings between the partners and the partnership will take on a tax effect they never had before.

Another thing that is important, because it represents a tremendous change, is that salaries of partners will be considered as an expense of the partnership. However, the time for reporting these salaries will be the same as the time for reporting the profits of the partnership. Under the House Bill they did not do that, and it made possible all sorts of inequities as well as loopholes.

Another very important change dear to the hearts of us accountants, if not our clients, is what will happen in respect to the effect of the death of a partner, or the sale of his interest. The House Bill had a rather arbitrary arrangement whereby, if I die and under my partnership agreement my estate continues to have an interest in the firm's profits for the next ten years, then for the first five years my estate would have to report its share of the firm's profits, but anything thereafter was tax-free to my estate. In turn, after five years the surviving partners or continuing partners had to report all of the partnership profits, even though some went to my estate.

That is kicked out, and we are now back again to first principles, whereby the continuing interest of a decedent or a selling partner in the earnings of a partnership will be taxed to the estate or the vendor as income from the partnership, regardless of time, and the survivors will be taxable only on their remaining share of the partnership profits.

There are a few things pertaining to administrative provisions. You know, March 15 has been the coveted Ides of March date for the filing of income returns by individuals. In the future, April 15 will be the day when a fellow's income becomes a collector's item! In the case of corporations, the March 15 date will continue, but a corporation will be able to help itself automatically to a three-month extension of time.

Individuals have to file estimated declarations of estimated tax, and many individuals have run into substantial penalties. Those penalties are being confined to about 6 per cent interest on the tax deficiency.

Corporations are now being invited into the charmed circle of those who will be called upon to file advance estimates of their tax, because hereafter (starting in 1955), corporations that face a tax liability of $100,000 or more will have to make such declarations, and will ultimately have to pay half of their tax in the year in which the income is being earned.

One of the simplifying factors is that a corporate return hereafter will be valid if it is signed by any one official, instead of two officials. Finally, birth pains attendant upon the birth of this terrific bill, you can expect another tax bill that will contain technical provisions applicable to prior years, with retroactive coverage either by way of relief or loophole closing. The present bill deals only with the current and future years.

DISCUSSION

CHAIRMAN SCHWARZ: Thank you, Jack. The applause says more than I could.

I think that we should carry on for a while with a question and answer period. Any questions that you have, kindly rise, state your name, and the name of the speaker to whom the question is addressed.

FROM THE FLOOR: Mr. Seidman, is it still safe to apply Section 41 to switching of a calendar year tax payable to fiscal year on partnership or individuals?

MR. SEIDMAN: You are confiing it to a partnership. Is it still safe to switch an individual or a partnership from a calendar year to a fiscal year? The answer is yes. The partnership provisions will not become effective until 1955. The restriction on fiscal years does not apply to individuals at all because there is no tax gimmick involved. Ordinarily, when an individual switches, there is a short accounting period that has to be annual-ized, and the government may wind up getting more tax revenue, so you are still safe in going ahead, acting under the rules as they now stand in respect to switches of accounting periods.

FROM THE FLOOR: Mr. Seidman, on a company that was purchased in 1953, for the loss carry-back, will this law affect that company?

MR. SEIDMAN: A company purchased in 1953? No. The new law will not apply to that. It deals only with switches that took place in stock interests after March 1, 1954. I say the new law; that is really the bill. I do not know what will finally emerge. The Senate Finance Committee has not yet considered this particular provision, but the House Bill restricts the operation of the close-down on the loophole only on transactions that took place after March 1, 1954.

CHAIRMAN SCHWARZ: Can we put Mr. Richardson to work? Who else has a question?

FROM THE FLOOR: Mr. Richardson, to what extent are increased excise taxes used in the next five years?

MR. RICHARDSON: I deliberately stayed away from a guess as to whether we might make the change, other than pointing out the possibility of the change, because I think the answer is purely a political answer. I think that the studies to which I referred indicate the confidence of the CED, for example, and the need of a switch. Most of our present ranking Treasury officials have a background of association with the CED.

Obviously, from published talks that have been made, the present administration feels that they may have to turn to a general excise tax or something of that nature. There has been a definite effort to avoid it, but they have indicated in all public addresses that that is a possibility, and it is under consideration. It has never been abandoned at any time by any one speaking on the subject.

I think that politically we are going to find the answer, and it will be in whether the administration presently in power stays in power, whether it feels that it has to go ahead to balance the budget ultimately, and if it does, that will be the only answer. Perhaps a change of administration may go back to the old philosophy that you do not balance the budget.

FROM THE FLOOR: I would like to ask Mr. Seidman, are the pension plan provisions of the House Bill being changed?

MR. SEIDMAN: They are going to be changed. Just what form the change will take is not too clear. Perhaps the most significant change that will take place will have to do with the restrictions now in the House Bill as to the character of investments by the pension trust. The House Bill, for the first time, writes in limitations as to how the assets of a pension trust can be increased. I have a feeling that most, if not all of those restrictions will be yanked out by the Finance Committee.

CHAIRMAN SCHWARZ: I regret that it is time we should adjourn. Before doing so, I want to thank Mr. Richardson and Mr. Seidman again for the effective presentation. I am certain, from your applause and attentiveness, that they have done a tremendous job.

This meeting is now adjourned.

SIXTH SESSION

FRIDAY, MAY 21, 1954—12:30 P.M.
The Ohio Union — East Ballroom

Presiding:

GEORGE W. SCHWARZ, *President, Controllers Institute of America, Inc.; Vice President and Treasurer, Wyandotte Chemical Corporation, Wyandotte, Michigan*

Paper: "The Business Outlook"

MERLE HOSTETLER, *Director of Research, Federal Reserve Bank of Cleveland, Cleveland, Ohio*

SIXTH SESSION

Introductory Remarks

Chairman Schwarz: It is a genuine pleasure and I am sincerely honored to appear before you a second time today. I am fully aware that my participation in your program is occasioned by the fact that I represent the Controllers Institute of America as its national president. With your indulgence, I should like to pay my respects to that fine group of men constituting our membership. It is they who have made possible my appearance on your platform. I am proud to represent them.

The gentlemen at the head of the table have already appeared before you at one time or another. They have been introduced. I am sure you are aware of their accomplishments. I will not take time to introduce them, but I will ask them to rise and be recognized.

In accounting, emphasis on the past is giving way, more and more, to the forward look. We record facts and figures for their significance in future planning. Many of us devote more time to projections, forecasts, budgets and interpretations than we do to other phases.

Because of this, we have a constant interest in predictions and opinions on the future course of business. For this reason, your program committee has wisely arranged to close this Institute with an appraisal of the business outlook. We can also thank them for giving this assignment to one of the leading economists in the country, Mr. Merle Hostetler.

Our guest speaker has been with the Federal Reserve Bank of Cleveland since 1943, serving first as financial economist of that institution. He was promoted to manager of the Research Department in 1946; became assistant vice president in March, 1953; and in June of last year, was named director of research.

A native Ohioan, Mr. Hostetler studied, and then taught, at Western Reserve University. He wrote a study called "75 Years of American Finance," and has also contributed numerous articles to financial and business magazines. His broadcasts on "Business Trends" for his bank are heard by millions of listeners.

Active in the Cleveland Society of Security Analysts, he also belongs to the American Economic Association, the American Statistical Association and the American Finance Association. He served on the Committee on Foreign Relations of the Cleveland Council on World Affairs.

It is my privilege and pleasure, sir, to present you to this audience. Ladies and gentlemen, our guest speaker, Mr. Merle Hostetler.

THE BUSINESS OUTLOOK

By
MERLE HOSTETLER
Director of Research
Federal Reserve Bank of Cleveland, Cleveland

Mr. Schwarz, Dean Weidler, members of the Institute on Accounting, and guests:

I wish I could share your explanation, Mr. Schwarz, as to why the committee on arrangements should have taken the risk of inviting an economist to appear before you, particularly at the closing session of the Institute.

From what I have heard in the corridors and elsewhere on the premises, up to this point this session has been a very enjoyable and fruitful affair, has produced fellowship, and has brought forth provocative and instructive information to you.

And now you invite an exponent of what has long been known as a dismal science. If the economists had been asked to launch this series of sessions, I could perhaps understand it, on the assumption that you would feel that by the time all the other meetings had taken place, some of the gloom and misgivings could have been diffused and disseminated.

Now, you have taken a chance that I am going to express a lot of misgivings about the future, about the welfare of our country. Not only that, but about your own ability to make a living.

I am therefore somewhat gratified to notice that there has already been some attrition in the attendance. Perhaps before I am through, something on the order of accelerated amortization will have taken place.

Let me utter this word of warning right now, that no accountant is ever going to attain the Hall of Fame by listening to an economist. I dare say that some of you are perhaps anxious to be getting back home to see what kind of trouble the rest of the office might have found itself in while you are away, and perhaps the committee felt that anyone who is negligent of his own affairs does not deserve anything better.

I might also say that if you hear me mention anything beyond a two-digit figure in the next 30 minutes, you have the privilege of rising to a point of order.

I am convinced that everyone in this room already has considerable knowledge of the present state of business, of economic conditions. You know that at the moment the steel industry, the basic industry of the country, is operating at approximately two-thirds of capacity. You are aware that there is a mild volume of unemployment. Some may disagree with that. You may supply your own adjective. And you also know as accurately as does the Department of Labor, about how many are unemployed.

I do not know how many of you watch the conditions in the automobile industry. But in Cleveland and Chicago where there is alleged to be almost as much unemployment as anywhere else in the country, the number of new cars being sold is nearly as large as it was last year this time, and that I regard as a near miracle. When you sell that many cars without pushing doorbells, I wonder how many could be sold if the salesmen were to go outside the salesroom and ring doorbells, or make telephone calls.

I think that you must be acknowledging the fact that construction activity on the whole is establishing new records right now, and it gives promise of being probably the largest construction year in this country's history.

You have to take into consideration that prices of all kinds have been remarkably stable throughout the past ten or eleven months, at a time when business allegedly was in some kind of decline. You would never guess it by looking at a price index.

I do not know how things are in your home town, but I suspect that retail trade almost universally is giving a very good account of itself, give or take one or two per cent from last year. There again, if you watch only those figures, you would never suspect this country is in any kind of a recession.

Finally, you are aware that the people of this country do have stashed away somewhere a rather substantial volume of savings in one form or another.

In looking at this, I think we must recognize that the people who are incurring some of this installment and mortgage debt are not necessarily the same people who are doing the savings. I cannot help but express an analogy in this football-minded place in that respect. We are operating a two-platoon system in this country.

Now, I suspect that I did not tell you anything new up to this point. I suspect that each of you has already consciously or unconsciously adopted some points of view, some opinion, about the picture this makes. You are just as capable as I am of drawing up your own trial balance of these factors, debits and credits, which I have just mentioned. I recognize that it takes time, but you do have an opinion.

You have an opinion about the business outlook, which you may, or may not have expressed, just the same as you do about major league baseball teams, or about the horse races, and I daresay that you would be extremely startled if you were to go on the opening day of the baseball season in Cincinnati, Cleveland or Detroit, and as soon as you had settled yourselves comfortably, and it was about time for the game to start, the fellow in the blue suit were to come out to home plate, ask for the microphone and announce to the opening day crowd that it is his opinion that the New York Yankees are going to win the league championship by at least four games. Would you not be startled? Not only that, but after the first two or three close decisions, you would say to yourselves, "What in the world is this about?"

Or if the judges at Churchill Downs three weeks ago had announced over the public address system that a certain gray colt was going to win by so much. What is the connection?

The connection is simply this, that I represent an institution in this country which performs some of the functions of an umpire or a referee. The Federal Reserve system has the responsibility of creating, promoting or fostering a financial climate that is conducive to a high level of employment, stability of prices and some improvement in the standards of living.

Now, I should be crazy enough to stand up here and say what the Federal Reserve system thinks is going to happen! Your reaction would be the same as if this umpire got up and said what he thought about the Yankees. Either he knows what he is talking about, or he ought to keep quiet. Otherwise the whole thing will be a farce.

The Federal Reserve system is interested in maintaining reasonably satisfactory playing conditions on the field, in keeping the crowd in order, and most of all in seeing that this financial ball is not so lively that a mere one-hundred hitter can hit the ball out of the park every time, and not letting the ball get so dead that even the three-hundred hitters cannot get it out of the infield. That is about as far as we want to go, and obviously, it will be quite inappropriate for me to predict the outcome of the game.

First of all, I do not know, and if I did, I would not be here. And if I do not know, why should I be talking? How am I going to get out of this dilemma? It is high time I am thinking about it, is it not?

I was informed just after I came up to the table, that there would be no question period. You are a captive audience, and this is going to be a one-way conversation. So I am going to ask the questions, and you may reply to them in your own way. I know they will be just as valid, although there will be a tremendous area of difference of opinion.

Many times I adopt the philosophy of trying to find out first what a man's character is. Is he a born optimist, or a pessimist? I tailor my remarks to what I think he needs. If I think he is too bullish, I give him the business. If I think he is too bearish, I try to give him something pleasant to think about. You are all mixed up here today.

So in the next ten or fifteen minutes I am going to talk to these men on this left side. They are the optimists. You on this other side are the pessimists. That makes those in the center mugwumps. If I recognize that you in the center run the risk of developing a split personality, I will take steps. But having been forewarned, you are forearmed.

Let me talk to the optimists, who see nothing but the green light as far as you can see. Do you optimists feel that this country has finally learned how to avoid and to prevent hard times? Are you persuaded that this country will never get itself into a situation of overextension of debt, of inventory, and everything else of the kind that resulted in collapse in the past?

Are we so smart that nothing of that kind is ever going to happen again?

Secondly, and somewhat corollary to that, are you persuaded that the little recession of 1949 and the little minor readjustment that we are in now are all the shake-out we are going to have after World War II and Korea?

You can go back over this country's history and the various wars, and see that inflation repeatedly has been followed by a rather painful readjustment, more painful than anything that has occurred in the last twenty years.

You optimists, how do you reconcile your optimism with the vast amount of industrial expansion which has occurred in the steel industry—in many industries? Notice all the new facilities that have been constructed in the last nine or ten years. How can you be sure that all of that capacity can be digested and absorbed in the economy without causing a pretty stiff competitive struggle for survival?

You optimists, are you persuaded that there is no end to the series of annual rounds of wage increases? Do you really believe that this country has found the fountain of eternal purchasing power? Every time it sags a little, there is another round of wage increases, more purchasing power; can this keep up as long as we like?

And finally, do you acknowledge that this country has been in many respects living beyond its means? That people have gone into debt which we have acquired through our government, state, local, federal government, and as individuals have lived beyond our means? Do you believe that that kind of process can keep on indefinitely?

You can remember, and I can, too, when it used to take a fairly sizeable down payment to buy a house. Now, you can buy a house without any down payment, if you find the right lender, and the monthly payments are less than the rent would be for an equivalent house.

Now, to tap that kind of a market, you will agree, is a wonderful thing. It is very stimulating, but what do you do when that runs out? Start a kind of negative down payment? I do not know. I have not seen anyone leave the room, and I suspect it is nothing but sheer courtesy and politeness that has kept you here, because if you have been listening to what I have been saying to these optimists, you must be very much more discouraged than you were.

I am now addressing my remarks to the pessimists. I am going to ask you gentlemen whether you see any evidence in the business picture that the decline in production since last July is any more than in inventory readjustment. Do you see any evidence that it goes deeper? Or that there is an underlying difference of any kind? Do you have any evidence to bring to the court to show that this is just the beginning of a very serious readjustment?

Do you see any evidence of speculative collapse in any area of the economy such as real estate, commodity prices, the stock market or anything else? Do you see any evidence of a speculative collapse? Do you see a growing list of insolvencies, bankruptcies of the kind that you can well remember when really serious readjustments were on the way?

There is financial pressure, but not on the part of the lending institutions. The pressure in recent months has been by the debtor who, without mercy, is paying off the banks. If it were the other way around, if you could draw up a list of firms being pressed against the wall by the lending institutions, then you can say, "We are in for trouble." But when the business enterprises reduce inventory and pay back banks, that is working out a solution along sound lines.

Do you see any evidence that the working capital of this country, I mean the cash-on-hand-and-due part of the working capital, is being impaired? I do not believe that you do.

In examining balance sheets, corporate and individual, you will find that that segment of working capital, the money supply of the country, is just as large (or larger), today, as it was a year ago, in spite of unemployment which has occurred, in spite of the production and some shrinkage of sales. The working capital, the spending money, is there. It is a matter of the willingness of people to use it.

One or two more questions. Can you recall, out of memory, any occasion when this country was at the point of dropping into a serious recession, that construction was as active as it is today? Or can you ever remember a time when a sharp business depression occurred that was not really preceded by a weakness in raw material prices? That is almost a sure fire weakness of a long industrial recession. Do you see any of that now? As far as either of those elements are concerned, who among you is ready to say that all the building that is needed in this country is going to be accomplished within the next year or so?

I have a habit of referring to the present phase of business as the turnpike boom. Students of economic history will recall the railroads, in their building booms, and the automobile boom. It looks very much as if we are in something that is a turnpike boom, not thinking merely of the four-lane highways, but all the access roads. Not only that, but consider the schools and public buildings of all kinds that will some day be built.

Finally, what about the world in which we live? I am still talking to the pessimists now. I will ask you this question: Would you say that when Isaac Watts stumbled across the principle of a steam engine, and the age of steam power, the industrial revolution was ushered in—was he rendering a disservice to business enterprise and economic activity? To ask that question is to answer it. When the internal combustion engine was developed, no one could foresee all the ramifications of that development which I like to call the beginning of the hydrocarbon age.

Now, we have a new age, the atomic age, or the age of nuclear fission. No one in this room has the remotest idea as to what that is going to be in the way of a higher standard of living. I will grant that it may be used in a devastating way.

I recognize that there are two idealogies which have at their command now a most dreadful weapon, one that is capable of unlimited damage. But I have sufficient faith in a Divine Providence, in the destiny, meaningfulness of human affairs, that I do not believe that this planet was created by accident, nor that it will be destroyed by accident. I can visualize that the free nations of the world will be confronted with a hostile ideology all around themselves, much like the ancient Israelites in their campaign in the Land of Canaan were up against, with the foe on every side.

Our mettle is going to be tested daily in the future. We are going to have to be in a position to defend ourselves, not only morally but also physically. (I am still talking to the pessimists.)

You remember when Caesar was going up and down Gaul. He was going up and down Gaul, trying to subdue the various tribes, and his camp was a scene of great activity. Everybody had a job to do; the chariots and the equipment had to be kept in fine shape; the impedimenta had to be thrown up, and there was simply no unemployment, or time for leisure in an armed camp.

Do you not think it possible that for as long as you and I shall live, this country is going to have to live in the equivalent of an armed camp, and if so, whether it be a Communist, Totalitarian, Democracy or Republic, there simply will not be time or place for more than an ordinary amount of leisure?

I have one neutral question. I tried to say what one of the functions of the Federal Reserve system is. The Federal Reserve system today does have the power, the authority, the ability, and the capacity to bring about a lot more inflation than has been brought about or exists at the present time, without any change in the laws or anything else.

Are you as individuals, as business men, as accountants, auditors and controllers, willing that such inflation shall be brought about so that for years to come, no buyer of labor, no employer ever needs to worry about how he is going to meet this additional round because inflation will take care of that, and no seller will have to sharpen his pencil in order to sell a commodity because inflation will take care of that also?

Or are you of the persuasion, perhaps, that the time is at hand when the economy, the whole business community, individuals and companies alike, should be given a chance to pull their own weight, to stand on their own feet without leaning on the inflation continuously?

I have not expressed any opinion on the business outlook. So let me begin by saying that I think that the lowest month of the 1953 and 1954 recession, as somebody called it, is behind us. The lowest month is behind us; the balance of the year will see business as a whole running at a higher level than it has over the past five months.

That is not a prediction. That is merely a frank and candid expression of my own opinion. Thank you very much for listening.

CHAIRMAN SCHWARZ: For one who started so modestly, isolating the optimists, the pessimists and the mugwumps, I think our speaker arrived at a conclusion that indicates some degree of optimism, and I am glad to have him making that kind of a statement.

This is the first time that I have been privileged to attend your Ohio State Institute on Accounting. I have known of the excellence of the speakers at earlier Institute meetings, and of the quality of their remarks. I have read many of their papers in your published proceedings. I am doubtful, however, that the addresses we have heard yesterday and today could have been excelled on any former occasion.

It is my pleasure to thank again all of our speakers for the timeliness of their subject matter and the excellence of their delivery; Hermann Miller and his associates for the judgment exercised in developing such an outstanding program; and lastly, our host, that great institution of learning, The Ohio State University, for their hospitality, the use of this very beautiful and functional Student Union Building, and for their continued contribution to our knowledge.

We extend our blessings and ask that you come again next year.

The sixteenth Annual Institute on Accounting is now history. The meeting is adjourned.

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